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S. Hrg. 100-918

TO REPEAL OR REVISE THE McCARRAN-FERGUSON ACT

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 80

A BILL TO REPEAL THE McCARRAN-FERGUSON ACT, AND FOR OTHER PURPOSES

AND

S. 1299

A BILL TO AMEND THE McCARRAN-FERGUSON ACT TO LIMIT THE FEDERAL ANTITRUST EXEMPTION OF THE BUSINESS OF INSURANCE, TO REAFFIRM THE CONTINUED STATE REGULATION OF THE BUSINESS OF INSURANCE, AND FOR OTHER PURPOSES

FEBRUARY 18 AND JUNE 2, 1987

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S. 80—LEGISLATION TO REPEAL OR REVISE THE McCARRAN-FERGUSON ACT

WEDNESDAY, FEBRUARY 18, 1987

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 10:10 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Howard Metzenbaum, (chairman of the subcommittee) presiding.

Also present: Senators Thurmond, Biden, Hatch, Humphrey, Specter, Simon, Heflin, and Grassley.

Staff present: Christopher Dunn, counsel.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator **METZENBAUM**. I want to apologize for being late. We had a press conference on plant closing legislation and one of the participants decided it was time to filibuster and it took a little longer than we thought.

This hearing is about one fundamental question. Why should the insurance industry not abide by the rules of free competition that other industries follow? Since 1945, the insurance industry has been exempt from Federal antitrust and consumer protection laws.

This exemption, known as the McCarran-Ferguson Act, allows the industry to avoid the discipline of the marketplace in establishing rates, in setting terms of coverage, and in furnishing information to policyholders.

The McCarran-Ferguson Act was passed at the urging of the insurance industry in 1945 after the Supreme Court ruled that insurance was subject to Federal antitrust laws. Supporters of the Act agreed that it was necessary to make sure that the States could continue to license, tax and regulate the insurance industry. There is nothing in this bill to change that.

The McCarran-Ferguson Act, however, has had effects far beyond simply ensuring that the States can tax and regulate insurance. Today, it is clear that no expressed statement by Congress is needed to give States the authority to regulate an industry subject to the Federal antitrust laws.

But McCarran-Ferguson has had the effect of exempting one of the biggest industries in this country from the basic rules of free competition. By going beyond the simple statement that the States could regulate insurance and by exempting the industry from the antitrust laws, Congress enacted one of the most anti-consumer, anti-competitive laws in the history of Federal legislation.

Almost every American has experienced the harm caused by the McCarran-Ferguson exemption. Those who buy houses pay a fixed rate for title insurance, not one set by free competition.

Small businesses face enormous and often unjustified rate increases, in part because of the industry system of relying on jointly-recommended premiums. Doctors are retiring from practice, with new stories every day on that issue, rather than pay exorbitant increases in premiums when they have no idea how or why these drastic increases were determined.

Some businesses are being forced to close their doors because they are unable to obtain coverage at a reasonable rate. Yet, they cannot obtain any information, they cannot get the facts, they cannot find what the basis of the increases are as to why they were singled out for increases of 100 percent, 200 percent, and sometimes 600 percent or more in premium rates.

Last Congress, the insurance industry claimed that it was losing money; that it could not survive without drastic legal changes. Now we learn that the net income after taxes of the property and casualty industry rose from less than $2 billion, $1.9 billion, in 1985 to $11.5 billion in 1986, an increase of 500 percent.

Have consumers as a consequence benefited in the form of lower rates? Have small businesses, doctors and lawyers, suddenly found that their premiums are going down? Absolutely not.

Insurance is simply too essential to every American to continue this unwarranted exemption. If you believe in free enterprise, if you believe in free competition, you cannot believe that the largest industry in America is entitled to an exemption from the antitrust laws.

In 1977, a task force appointed under President Ford recommended modifying the McCarran-Ferguson Act. A Government Accounting Office report in 1979 found serious shortcomings in the way the insurance industry sets rates.

In that same year, the National Commission to Review the Antitrust Laws called for making drastic revisions in the McCarran-Ferguson Act. Since then, many bills have been introduced to do just that. I have introduced legislation to do so this Congress; Senator Simon also has in the past.

Today's hearing is the first of a series of hearings we will have on this important issue, but let no one misunderstand the fact that there will be additional hearings. We intend to bring this bill to a head, to a mark-up at the earliest possible date.

The insurance industry says that it is already regulated by the States, that the public is adequately protected from price-fixing and deceptive practices, and that the consumer has the benefit of vigorous competition. That is unadulterated hokum; it just is not so. That is not the reality of the world in which we live.

Let us look at the facts. Today, the property and casualty insurance industry does not set rates by free competition. Instead, insurance companies rely on an elaborate nationwide system of recommended rates, rates recommended by an organization totally controlled by the industry. This practice would be illegal in any other industry.

State insurance commissions attempt to regulate insurance practices within their States, but they are simply too small and too underfunded to take on some of the nation's largest firms.

Most States require a filing of rates, but the insurance commissioners do not have the time or the ability and, in many instances, the right to review them adequately. The result is to rubber-stamp whatever the industry submits.

And there is another problem. Too many insurance commissioners spend their time planning for the day when they will land a lucrative job with the industry, and too many insurance commissioners have come from that very industry and look forward to the day when they will return to it.

The bill I have introduced would not eliminate State insurance commissions. It would not substitute Federal regulation for State regulation. It would not create any new Federal agency. It would simply make one basic change in the law. Insurance companies would be subject to the same rules of free competition and free enterprise that other industries in this country follow.

Each time the insurance industry's practices are questioned, it mounts an aggressive lobbying campaign to protect itself from competition. This year will be no exception. The industry's well-healed PACs will be operating in full force, but it is time to say no to the power of the insurance lobby. It is time to say this industry must operate by the rules of free competition. I hope my colleagues will join me in repealing this outdated law.

We are very happy to have the ranking member of the Antitrust Subcommittee joining with us today, as well as several other members of the subcommittee, Senator Thurmond.

OPENING STATEMENT OF SENATOR STROM THURMOND

Senator THURMOND. Thank you very much, Mr. Chairman. The McCarran-Ferguson Act has been in place for 41 years. It was enacted in 1945 to preserve the role of the States in taxing and regulating the activities of insurance companies operating in the States.

While I do not generally favor exemptions from the antitrust laws for specific industries, the McCarran-Ferguson Act represents a longstanding policy decision that seems to have served its purpose well and should not be reversed lightly. While I will consider the hearing record with great care, it is my view at this time that the McCarran-Ferguson Act should not be disturbed.

The call for repeal of the McCarran-Ferguson Act is being made in response to an alarming crisis in the availability and price of certain lines of commercial insurance. Yet, there is apparently no evidence that this crisis has anything to do with conduct that would violate antitrust law.

As I am sure we will hear, the causes of the problems in the commercial liability insurance market are complex but have nothing to do with collusion. Therefore, repeal of McCarran-Ferguson will not solve the insurance availability problem.

Many States are encouraging more competition through their regulation of insurance. While this seems to be a desirable trend under the system of insurance regulation we have established, such decisions are up to the States. I favor leaving such matters up to the State legislatures and their regulators, as Congress saw fit to do in 1945.

To reverse the venerable McCarran Act may produce no real benefits but may result in substantial disruption and loss.

Thank you, Mr. Chairman. I look forward to the testimony of the witnesses and I thank them for appearing here to contribute to our deliberations.

Senator **Metzenbaum**. Thank you, Senator Thurmond.

Senator Simon.

OPENING STATEMENT OF SENATOR PAUL SIMON

Senator **Simon**. Yes, thank you, Mr. Chairman, and I want to apologize to you and my colleagues on the committee. We have a mark-up on the Contra aid question in the Foreign Relations Committee and I am going to have to get over there. I hope to get back here before too long.

The reality is we are going to have to have a change. When I hear from the trial lawyers, they say the insurance industry needs to be changed. When I hear from the insurance industry, they say the tort system needs to be changed, and the reality is both sides are right.

I come from a State with a very healthy, powerful insurance industry, and I want to keep this insurance industry a strong, healthy, powerful industry. Insurance happens to be one of the few ways Americans save effectively.

An insurance agent comes around and in a moment of wisdom or folly, sometimes we are not sure which, we sign on the dotted line. We sign up for that insurance and we save, and that is good for us.

But representatives of the insurance industry who are here, including my friends from Illinois, would be wise to recognize this train is coming down the track. You can say let us stop the train and then maybe get run over, or you can help us find a sensible answer.

Senator Thurmond has talked about the McCarran-Ferguson Act and its wisdom. The reality is that the antitrust exemption contained in the McCarran-Ferguson Act was put on in a conference committee. Attorney General Jim Shannon from Massachusetts has been in a few of those conference committees here in the House and the Senate. The antitrust exemption was added in a conference committee without any hearing, without a thorough examination of its implications before either the House or the Senate.

There really is no justification for a nearly total exemption from antitrust laws. The majority of people in the insurance industry do not abuse the law and should not be standing up for those who do abuse the law.

We are going to have to protect the American public a little more effectively than we do, and when you have a combination of representatives of the Reagan administration and Senator Metzenbaum saying change is desirable, as has every study of this question, except for studies inaugurated by the insurance industry, I think anyone who dispassionately views this has to come to that conclusion.

Let me add, Mr. Chairman, that one of the witnesses today is Bob Seiler, a very respected insurance executive from Illinois. I hope to get back here to hear his testimony, but in the event I do not, I want you to treat him with some kindness here, Mr. Chairman, all right? [Laughter.]

Senator **Metzenbaum**. We will be very kind and we will be cooperative and we hope to work with him as well as every other insurance industry representative.

Senator **Simon**. Thank you.

Senator **Metzenbaum**. Senator Hatch, do you have an opening statement?

Senator **Hatch**. Let me yield to the distinguished Senator from Pennsylvania—I understand Senator Humphrey is happy to do so, too—and then if I could continue after that.

Senator **Metzenbaum**. No problem.

OPENING STATEMENT OF SENATOR ARLEN SPECTER

Senator **Specter**. Mr. Chairman, thank you. I thank Senator Hatch and Senator Humphrey for yielding. We have hearings in the Intelligence Committee with Mr. Gates and I am going to have to go there for the 10:30 beginning, but I will return here when I can.

I want to commend you, Mr. Chairman, for your leadership on this important issue and for convening these hearings. In my judgment, there are very, very important questions raised here.

There is certainly a massive problem in this country today on the issue of verdicts in tort cases and the difficulty of obtaining liability insurance, and I think these are issues we are going to have to take a look at. Whether repeal of this statute is appropriate is something that will have to be determined after we have the hearings.

I would like to note on the panel today Mr. Brad Mitchell, Chief Executive Officer and President of Harleysville Insurance Company of Pennsylvania, a very distinguished insurance executive who will be providing testimony on panel three.

As I say, Mr. Chairman, I shall try to return and I thank my colleagues for yielding to me.

Senator **Metzenbaum**. Thank you, Senator Specter.

Senator Hatch.

OPENING STATEMENT OF SENATOR ORRIN G. HATCH

Senator **Hatch**. Thank you, Mr. Chairman. I want to congratulate you upon your chairmanship. These are important issues. They are issues I am extremely interested in, and I look forward to working with you and I pledge my willingness to work cooperatively with you and Senator Biden and other members of the majority on issues that this committee will have the opportunity to address during the next couple of years.

Now, the subject of this hearing takes me back a number of years—too many years, as a matter of fact—to the time shortly after I entered the Senate. By Executive Order 12022, President Carter appointed me and a few others—I believe Senator Metzenbaum was one of the people—to the National Commission for the Review of Antitrust Laws and Procedures.

For more than a year, we labored on the Commission to make some sense out of the mish-mash of antitrust legislation and litigation. In January of 1979, the Commission issued its report recommending, among other things, repeal of the broad antitrust immunity of the McCarran-Ferguson Act.

At the time, that conclusion puzzled me because the Commission itself had affirmed that special antitrust exemptions for insurance were warranted and had noted that the McCarran Act fosters competition.

The economic advisory panel for the Commission even concluded that, "The repeal of the Act alone will have little, if any, effect on the extent of price competition in this industry."

Now, nearly 10 years later after it began, we are back where we began, or at least back where I began, because the whole issue had been debated numerous times before I came to Washington.

In 10 years, however, there have been changes, and I look forward to reviewing the record to ascertain if the McCarran-Ferguson Act continues to promote intense and meaningful competition in the insurance business, and I intend to revisit this issue with an open mind.

Several things, however, seem not to have changed. For instance, I presume that insurers, unlike almost any other business, still must price their product without any knowledge of its true cost. Therefore, the insolvency of an insurance company and its ability to serve consumers must still depend on its ability to predict future losses and all of the economic factors and tort law uncertainties affecting those losses.

Accordingly, it seems to me that some sharing of loss data and cooperative pooling of excessive risks have probably benefited consumers as well as insurance companies.

I am also impressed that there are still somewhere in the neighborhood of 3,500 insurance companies in the business. In fact, the top five companies do not account for even 25 percent of the total insurance business. Now, this is one indication that competition does remain robust in the industry. I intend to look carefully for indications of inadequate competition in a business with so few barriers to entry.

Finally, I am anxious, along with my colleagues, to explore the causes of the insurance availability and affordability crisis. Some have argued that high interest rates a few years ago actually triggered excessive competition for premiums that might be invested at a high rate of return and that this excessive competition caused insurers to sell their product too cheaply.

Now, this may be the case, but I struggle to harmonize that problem with the proposed solution, and that is repeal of McCarran-Ferguson. I presume that Senator Metzenbaum will ultimately back off of a total repeal and just ask for the antitrust exemption. But be that as it may, if the cause of the problem is too much competition, it would seem illogical to advocate a change designed to increase the level of competition.

Now, with these questions in mind, I am anxious to hear from this impressive array of witnesses and I do welcome each of them to the committee and will study in detail the statements that each of them gives.

I might also add that Senator Simon made some interesting comments about the passage of the McCarran-Ferguson Act back in 1944. The Senate passed a strong bill with a very broad exemption. The House passed a bill that contained a more limited exemption; in fact, the antitrust exemption in the House bill was more limited than the Senate bill. They went to conference and that is when they came out with the limited exemption in the McCarran-Ferguson Act as it exists today. So it was not quite as Senator Simon recalls.

It is an important bill. It has served the public well, many feel, and Senator Thurmond raised some very important issues. I raise the issue, too, that I want to make sure that it will increase competition and not decrease it; that it will not increase burdensome regulatory authority; that it will not take away from the State's right to regulate the insurance industry, in spite of the protestations of those who are arguing that it really will not interfere with State commissioners of insurance.

I find that the Federal government has a voracious appetite to control everything. If you want a perfect example, look at the Civil Rights Restoration Act of 1984, ostensibly to overrule the Grove City case and reaffirm what they felt Title IX was before the Grove City case, but, in actuality, a trickle-down, trickle-up, trickle-around, Federal-government-into-everybody's-life type of bill that we have never seen the likes of before.

So I am concerned about this type of a change. On the other hand, I am going to keep an open mind. I am going to listen to Senator Metzenbaum and I am going to listen and read the statements of those here, and I hope that we can arrive at an appropriate solution to this problem.

Thank you, Mr. Chairman.

Senator **Metzenbaum**. Thank you, Senator Hatch.

Senator Humphrey?

Senator **Humphrey**. I will pass.

Senator **Metzenbaum**. That being the case, we are very happy to have Mr. Oliver, Chairman of the Federal Trade Commission, and Charles Rule, Acting Assistant Attorney General of the Department of Justice Antitrust Division.

We have indicated that we would like to hold to a 5-minute time limit. I think you have been advised of that. If you can, fine, and if you need a little extra time, we will try to be cooperative.

Before you begin Mr. Oliver, I wish to place copies of S. 80 and S. 1299 into the record.

[The bills follow:]

II

100TH CONGRESS
1ST SESSION

S. 80

To repeal the McCarran-Ferguson Act, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 6, 1987

Mr. METZENBAUM introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To repeal the McCarran-Ferguson Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Act entitled "An Act to express the intent of the Congress with reference to the regulation of the business of insurance", commonly known as the McCarran-Ferguson Act (59 Stat. 33), is repealed.

(b) The repeal made by this section shall be effective as to conduct engaged in beginning one year after the date of enactment of this Act.

SEC. 2. (a) In any action brought under the provisions of the Clayton Act or the Sherman Act alleging a violation of either such Act for conduct that would have otherwise been lawful pursuant to the provisions of the Act entitled "An Act to express the intent of the Congress with reference to the regulation of the business of insurance" no award of treble damages or criminal penalties shall be awarded against any such person for conduct by such person occurring within two years after the date of enactment of this Act.

(b) During the two year period referred to in this section, no relief shall be granted against any person in an action referred to in subsection (a) for conduct by such person during such period, if such person has, in good faith, relied upon an advisory opinion issued by the Department of Justice.

○

II

100TH CONGRESS
1ST SESSION

S. 1299

To amend the McCarran-Ferguson Act to limit the Federal antitrust exemption of the business of insurance, to reaffirm the continued State regulation of the business of insurance, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 29, 1987

Mr. METZENBAUM (for himself, Mr. SIMON, Mr. BIDEN, and Mr. KENNEDY) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To amend the McCarran-Ferguson Act to limit the Federal antitrust exemption of the business of insurance, to reaffirm the continued State regulation of the business of insurance, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Insurance Competition Improvement Act of 1987".

FINDINGS AND DECLARATION OF PURPOSE

SEC. 2. (a) The Congress finds and declares that—

(1) the continued regulation and taxation by the several States of the business of insurance is in the public interest; and

(2) the Federal antitrust laws comprise an essential component of congressional policy in favor of competition and consumer protection, and the current broad exemption from the antitrust laws afforded the insurance industry has adversely affected free competition and consumers of insurance.

(b) It is the purpose of this Act to promote free competition among insurers and to protect consumers of insurance by modifying the current antitrust exemption of the business of insurance.

AMENDMENTS TO THE MCCARRAN-FERGUSON ACT

SEC. 3. (a) The first section of the Act entitled "An Act to express the intent of the Congress with reference to the regulation of the business of insurance", approved March 9, 1945 (15 U.S.C. 1011), commonly known as the McCarran-Ferguson Act, is amended by striking out the period and inserting in lieu thereof the following: "; but that a continued broad exemption of the business of insurance from the Federal antitrust laws is not in the public interest.".

(b) Section 2(b) of the McCarran-Ferguson Act (15 U.S.C. 1012(b)), is amended by striking out all after "insurance" the second place it appears and inserting in lieu thereof a period.

(c) Section 3 of the McCarran-Ferguson Act (15 U.S.C. 1013) is amended to read as follows:

"SEC. 3. (a) Except as provided in subsections (b) and (d), the antitrust laws shall apply to the business of insurance and to acts in the conduct of such business.

"(b) The antitrust laws shall not be construed to prohibit any agreement, understanding, or concert of action between or among insurers, any insurance advisory organizations or their members, any individual insurers or any other persons that is limited to—

"(1) collecting, compiling, and disseminating historical data on paid claims or reserves for reported claims from insurers or any other source, provided that such information is made available to an appropriate State regulatory agency;

"(2) preparing and filing policy forms and endorsements for voluntary use by individual insurers;

"(3) conducting research and on-the-site inspections in order to prepare classifications of public fire defenses; and

"(4) collecting, compiling, and distributing information relating to fraudulent claims and other fraudulent practices, provided that such information is made available to an appropriate State regulatory agency.

"(c) Nothing in this Act or any State law shall render the antitrust laws inapplicable to any agreement to boycott, coerce, or intimidate, or to any act of boycott, coercion, or intimidation.

"(d) Insurers and other persons participating in joint underwriting, pools, or residual market mechanisms may, in connection with such activity, act in cooperation with each other in the making of rates, rating systems, policy forms, underwriting rules, surveys, inspections, and investigations, if the residual market mechanism is required by law or is approved by and subject to the active supervision of an appropriate State regulatory agency, or if the joint underwriting or pools do not unreasonably restrain trade.

"(e) Nothing in this Act shall be construed to prohibit any State from establishing or approving a residual market mechanism.

"(f) Nothing in this Act shall be construed to prohibit any State from requiring a worker's compensation and employers' liability insurer to adhere to the uniform classification system and uniform rating plan applicable to these categories of insurance in such State, but no such insurer shall agree with any other insurer or with an insurance advisory organization to adhere to or use any rate.

"(g) As used in this section, the term—

"(1) 'advisory organization' means any organization which is comprised of, or is controlled by, one or more insurers and which prepares policy forms and endorsements for use by its members or subscribers, compiles and promulgates insurance-related statistical data, prepares and revises insurance rating plans and classification systems, and provides assistance in the preparation of insurance rates;

"(2) 'antitrust laws' means the Sherman Act (15 U.S.C. 1 et seq.), the Clayton Act (15 U.S.C. 12 et seq.), and the Federal Trade Commission Act (15 U.S.C. 41 et seq.);

"(3) 'residual market mechanism' means an arrangement, either voluntary or mandated by law, involving participation by insurers in the equitable apportionment among them of insurance which may be afforded applicants who are unable to obtain insurance through ordinary methods;

"(4) 'joint underwriting' means a voluntary arrangement established on an ad hoc basis to provide insurance coverage for a commercial individually rated risk under which two or more insurers contract with the insured at a price and under policy terms agreed upon between the insurers, or negotiated between the underwriter and the insured; and

"(5) 'pool' means a voluntary arrangement, other than a residual market mechanism, established on an ongoing basis, under which two or more insurers participate in the sharing of risks on a predetermined basis by means of an association, syndicate, or other pooling agreement.".

SEC. 4. (a) This Act and the amendments made by this Act shall become effective one year after the date of enactment.

(b) In any action brought under the provisions of the antitrust laws alleging a violation of those laws for conduct that would have otherwise been lawful under the provisions of the McCarran-Ferguson Act on the day before the effective date of this Act, no award of treble damages or criminal penalties shall be awarded against any such person for conduct by such person occurring within two years after the date of the enactment of this Act.

(c) During the two-year period referred to in subsection (b), no relief shall be granted against any person in an action referred to in subsection (b) for conduct by such person during such period, if such person has, in good faith, relied upon an advisory opinion issued by the Department of Justice.

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Senator **Metzenbaum**. Mr. Oliver.

STATEMENT OF A PANEL CONSISTING OF DANIEL OLIVER, CHAIRMAN, FEDERAL TRADE COMMISSION; AND CHARLES RULE, ACTING ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. **Oliver**. Thank you, Mr. Chairman.

Mr. Chairman and members of the Committee, thank you for this opportunity to comment on S. 80, a bill to repeal the McCarran-Ferguson Act. In my view, this legislation is long overdue and its passage is unquestionably desirable as a matter of public policy.

Exposing the insurance industry to the brisk winds of competition, unimpeded by any Federal restraints other than the antitrust laws, can only serve to benefit consumers and promote the common welfare.

I note at the outset that although my remarks today are a reflection of my own views, a majority of the Commission is in agreement that the antitrust immunity conferred by the McCarran-Ferguson Act should be repealed.

The broad antitrust immunity enjoyed by the insurance industry under the McCarran-Ferguson Act is both undesirable and unnecessary. The exemption is undesirable because, by blunting some forms of competitive behavior, it denies consumers the best array of insurance services at the lowest possible cost. The exemption is unnecessary because application of the antitrust laws is in no way inconsistent with either desirable industry cooperation or effective State regulation.

Mr. Chairman, I start from the premise that, in the words of the Supreme Court, "the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest price, the highest quality and the greatest material progress. We rely on the free market to ensure that sellers will offer products and services with the best mix of price, quality, and other characteristics that consumers demand."

Exemptions from the antitrust laws are disfavored and the Supreme Court interprets them narrowly for that reason. Even as narrowly interpreted, however, the McCarran-Ferguson Act protects from normal antitrust scrutiny many activities that may injure consumers. It protects price-fixing, division of customers and territories, and imposition of uniform policy terms.

The McCarran-Ferguson Act purports to ameliorate its adverse effects by conditioning immunity on the existence of State regulation. Unfortunately, the courts have interpreted the Act's "regulated by State law" requirement very broadly, so that even a cameo appearance by the State will cloak private action with immunity.

Mr. Chairman, I believe it is not cynical to suspect that at least some insurers have taken advantage of McCarran-Ferguson immunity to harm consumers. As explained more fully in my prepared statement, a number of cases dismissed on McCarran-Ferguson grounds have involved allegations of anti-competitive activities lacking any redeeming social benefit.

Although repeal of McCarran-Ferguson may allow us to end some of these abuses, I do not want to leave the impression that passage of S. 80 will eliminate all anti-consumer activity in the insurance industry. While repeal of McCarran-Ferguson would help your constituents, it would not correct many other government-induced infirmities that afflict the insurance market.

According to insurers, their industry is so different from others that it deserves a special dispensation from the Nation's competition laws. Of course, virtually every industry has its own problems that can be—and are—cited to support special protection from the rigors of competition.

Congress has rejected many, but not all, of these special-interest appeals. It has granted antitrust immunity not only to the insurance industry, but to others, including agricultural cooperatives, which often fleece consumers under the cover of marketing orders. All special-interest exemptions from the antitrust laws deserve congressional scrutiny.

Forty years ago, the insurance industry managed to persuade Congress that the McCarran-Ferguson Act was essential both to preserve the States' autonomy to tax and regulate insurance, and to permit beneficial cooperation among insurers.

The tragic irony—for consumers—is that McCarran-Ferguson simply is not necessary to accomplish any of those goals. States may regulate insurers with or without McCarran-Ferguson. And the forms of insurer cooperation that would promote competition would not be unlawful under the antitrust laws. Moreover, the State action doctrine lives. Thus, repeal of McCarran-Ferguson would not change the States' role as the primary regulators of insurance.

Insurers suggest that repeal would lead to comprehensive Federal control, and will prevent them from engaging in legitimate cooperative activities. The inadequacies of these arguments, and others, are spelled out in the full text of my remarks.

There is broad agreement across the philosophical spectrum that exemptions from the antitrust laws are undesirable. Free markets are the foundation of both our economic prosperity and our political freedom. We make exceptions to the laws that ensure free markets at our peril.

The insurance exemption from the antitrust laws, in particular, has come under increasing attack. Eight years ago, the National Commission for the Review of Antitrust Laws and Procedures called for the repeal of the exemption. More recently, so has the National Association of Attorneys General.

The Supreme Court has done about as much as it can to limit the scope of the McCarran-Ferguson Act. The time has now come for Congress to act.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions you or any other members of the committee may have.

Senator **METZENBAUM**. Your entire statement will be included in the record, Mr. Oliver. Thank you.

[Prepared statement follows:]

STATEMENT

OF

DANIEL OLIVER

CHAIRMAN

FEDERAL TRADE COMMISSION

BEFORE THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

CONCERNING S. 80

A BILL TO REPEAL THE McCARRAN-FERGUSON ACT

FEBRUARY 18, 1987

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to comment on S. 80, a bill to repeal the McCarran-Ferguson Act. In my view, this legislation is long overdue, and its passage is unquestionably desirable as a matter of public policy. Exposing the insurance industry to the brisk winds of competition, unimpeded by any federal restraints other than the antitrust laws, can only serve to benefit consumers and promote the common welfare.

The broad antitrust immunity enjoyed by the insurance industry under the McCarran-Ferguson Act is both undesirable and unnecessary. The exemption is undesirable because, by blunting some forms of competitive behavior, it denies consumers the best array of insurance services at the lowest possible cost. The exemption is unnecessary because application of the antitrust laws is in no way inconsistent with either desirable industry cooperation or effective state regulation.

Before I develop these points, I must note three caveats. First, because the FTC Improvements Act of 1980 prohibits the Commission from studying the insurance industry without prior Congressional authorization, the Federal Trade Commission has not conducted a comprehensive review of the industry in recent years. We therefore lack detailed knowledge of current conditions. Nonetheless, what we do know from existing studies and from our enforcement activities indicates that the exemption is unjustified.

Second, although the Improvements Act constrained our authority to study insurance, it left intact our authority to challenge conduct by insurers that is not immunized under McCarran-Ferguson. We have accepted several consent agreements prohibiting insurers' boycotts of nurse midwives,[1/] and agents' boycotts of insurers.[2/] An ongoing adjudication explores the charge that title insurers have fixed the price of search and examination services,[3/] and our staff is investigating other industry practices that may fall outside the exemption. Because the title insurance matter is in adjudication and the other investigations are nonpublic, I cannot discuss further our current enforcement initiatives.

Third and finally, I speak only for myself, and not necessarily for the Commission or any of my fellow Commissioners. I note, however, that a majority of the Commissioners supports repeal of the McCarran-Ferguson Act.

The McCarran-Ferguson Exemption Is Undesirable

Mr. Chairman, I start from the premise that, in the words of the Supreme Court, "the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material

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[1/] State Volunteer Mutual Insurance Co., 102 F.T.C. 1232 (1983).

[2/] Independent Insurance Agents of America, Inc., C-3197 (August 25, 1986); Independent Insurance Agents Association of Montana, C-3199 (August 25, 1986); Independent Insurance Agents and Brokers of California, C-3198 (August 25, 1986).

[3/] Ticor Title Insurance Co., et al., D. 9190.

progress."[4] We rely on the free market to ensure that sellers will offer products and services with the best mix of price, quality, and other characteristics that consumers demand. The purpose of the antitrust laws is to prevent unwarranted interference with competitive market forces. The McCarran-Ferguson Act exempts the "business of insurance" from antitrust scrutiny, provided the insurance activities at issue are "regulated by state law" and do not involve a boycott, coercion, or intimidation.

Exemptions from the antitrust laws are disfavored, and the Supreme Court interprets them narrowly for that reason. In construing the McCarran-Ferguson Act, the Court has limited the "business of insurance" to activities directly involved in underwriting and spreading of risk.[5] Even as narrowly interpreted, however, the Act protects from normal antitrust scrutiny many activities that may injure consumers. Of course, the McCarran-Ferguson Act protects all manner of price fixing. Agreements among insurers to limit consumer options by using only certain policy forms and classification plans are also safe. Likewise, the Act allows insurers to divide customers and territories among themselves, and to impose uniform terms upon agents.

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[4] Northern Pacific Railway v. United States, 356 U.S. 1, 4 (1958).

[5] Union Labor Life Insurance Co. v. Pireno, 458 U.S. 119 (1982); Royal Drug Co. v. Group Life & Health Insurance Co., 440 U.S. 205 (1979).

The McCarran-Ferguson Act purports to ameliorate its adverse effects by conditioning immunity on the existence of state regulation. Unfortunately, the courts have interpreted the Act's "regulated by state law" requirement very broadly, so that even a cameo appearance by the state will cloak private action with immunity. Thus, some cases have held that the mere existence of a general scheme for insurance regulation constitutes sufficient state involvement to immunize a broad range of practices, including activities that the state has never directly authorized or even considered.[6] Indeed, courts have held that even where the state expressly prohibits a practice, the practice is "regulated" and thus exempt.[7] This is a bizarre way to further the interests of the states. As the National Commission for the Review of Antitrust Laws and Procedures pointed out eight years ago:

> Under the prevailing interpretation of McCarran-Ferguson, insurance company activities may be exempted from the coverage of the antitrust laws by the mere presence of a state regulatory scheme, without regard to whether these regulatory powers have been utilized to supervise the industry effectively. As a result, various types of collective insurance company behavior are, as a practical matter, wholly free from control by

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[6] Ohio v. Ohio Medical Indemnity, 1976-2 Trade Cas. (CCH) Par. 61,128 (S.D. Ohio 1976).

[7] Crawford v. American Title Insurance Co., 518 F.2d 217, 218 (5th Cir. 1975); see St. Paul Fire & Marine Insurance Co. v. Barry, 438 U.S. 531, 552 n. 24 ("prohibitory legislation" coupled with "an enforcement scheme of administrative supervision" constitutes regulation by state law).

either state regulation or the federal antitrust laws.[8]

Mr. Chairman, I believe it is not cynical to suspect that at least some insurers have taken advantage of McCarran-Ferguson immunity to harm consumers. Indeed, a number of cases dismissed on McCarran-Ferguson grounds have involved allegations of anticompetitive activities lacking any redeeming social benefit. For example, one court dismissed a suit claiming that 31 insurers had conspired to deny compensation for lost future earnings to individuals killed in car accidents. The plaintiffs alleged that the defendant insurers had taken concerted action to conceal claimants' rights and to refuse to offer coverage for future earnings.[9] In another dismissed suit, an asbestos manufacturer claimed that several insurers had conspired to deprive it of the full indemnification and litigation defense services that its policies provided. The suit also alleged a conspiracy to impose fraudulent policy interpretations on insureds and to limit the benefits that insurers would offer.[10] I do not know if the plaintiffs in these cases could have proven antitrust law violations, but the McCarran-Ferguson Act denied them the chance to try.

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[8] Report of the National Commission for the Review of Antitrust Laws and Procedures 226 (1979) ("NCRALP Report").

[9] Grant v. Erie Insurance Exchange, 542 F. Supp. 457 (M.D.Pa. 1982), aff'd, 716 F.2d 890 (3rd Cir. 1983), cert. denied, 464 U.S. 938 (1983).

[10] UNR Industries v. Continental Insurance Co., 607 F. Supp. 855 (N.D.Ill. 1984).

Besides encouraging attempts by insurers to fleece consumers, the McCarran-Ferguson Act wastes resources. Even when consumers win an antitrust case against insurers, they lose. It is costly for antitrust plaintiffs, including the FTC, to cut through a thicket of unfounded McCarran-Ferguson defenses.

Although repeal of McCarran-Ferguson may allow us to end some of these abuses, I do not want to leave the impression that passage of S. 80 will eliminate all anti-consumer activity in the insurance industry. Many state governments have passed laws and issued regulations that injure consumers by restricting competition.

An example may illustrate my point. Some states have prohibited insurers from establishing certain kinds of "preferred provider organizations," or PPOs. These organizations are an innovative approach to lowering health care costs. Georgia allows Blue Cross and Blue Shield to operate PPOs, but bars commercial insurers from doing so. Ohio thinks Georgia has it backwards: it bars Blue Cross and Blue Shield and other similar plans from having PPOs, but allows commercial insurers to offer them. Montana believes it has a better idea and prohibits PPOs entirely. I believe that the market will do a much better job than the states of deciding who is best able to provide PPO coverage.

I recognize that some state regulation is designed to assure insurer solvency and insurance availability. The wisdom of such regulation need not be addressed today. However, some forms of state government interference in the insurance industry harm consumers. In other industries, the Commission has an active program of consumer advocacy. We seek to explain to federal and state regulators ways in which government regulation may disserve the public interest. Unfortunately, the "Improvements Act" hinders us from advocating consumer interests with respect to the business of insurance. I would like to see that exemption lifted, but this, too, is a matter for another day. For now, let me emphasize that while repeal of McCarran-Ferguson would help your constituents, it would not correct many other government-induced infirmities that afflict the insurance market.

The McCarran-Ferguson Exemption Is Unnecessary

According to insurers, their industry is so different from others that it deserves a special dispensation from the nation's competition laws. Of course, virtually every industry has its own problems that can be cited to support special protection from the rigors of competition. The automobile industry, like other basic industries, argues for protection from foreign competition. The beer industry presses for the right to establish exclusive dealing arrangements even in situations where they would be anticompetitive.

Fortunately, Congress has rejected many of these special interest appeals. Unfortunately, however, Congress has yielded to many others, granting antitrust immunity not only to the insurance industry, but also to agricultural cooperatives, which often fleece consumers under the cover of marketing orders, labor organizations, certain professional sports leagues, ocean shipping conferences and others. All special interest exemptions from the antitrust laws deserve Congressional scrutiny.

Forty years ago, the insurance industry managed to persuade Congress that the McCarran-Ferguson Act was essential, both to preserve the states' autonomy to regulate and tax insurance, and to permit beneficial cooperation among insurers. The tragic irony -- for consumers -- is that McCarran-Ferguson simply is not necessary to accomplish any of those goals. States may regulate insurers with or without McCarran-Ferguson. And the forms of insurer cooperation needed for efficiency are perfectly legal under the antitrust laws.

Federalism

Insurers originally cited federalism as a justification for McCarran-Ferguson. In 1869, in Paul v. Virginia,[11] the Supreme Court had held that insurance was exempt from federal regulation. To the industry's shock, the Court reversed itself in 1944, in South-Eastern Underwriters.[12] That case upheld a Sherman Act indictment charging that a large group of insurers had used a rating organization to fix fire insurance premiums.

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[11] 75 U.S. (8 Wall.) 168 (1869).

[12] United States v. South-Eastern Underwriters Ass'n, 332 U.S. 533 (1944).

The decision created an uproar -- or rather the insurers did. Panic ensued as insurers told their Congressmen that state taxation and regulation of insurance would no longer be constitutional. Frankly, I do not understand how anyone made these arguments with a straight face. Maybe no one ever did. And certainly today, no one would seriously argue that the antitrust exemption of the McCarran-Ferguson Act is needed to authorize state taxation or state regulation of insurance. After all, plenty of other state-taxed and state-regulated businesses are subject to the federal antitrust laws, without anyone noticing any inherent conflict.

Moreover, as the Supreme Court's 1985 Southern Motor Carriers[13] decision illustrates, the state action doctrine lives -- some would say prospers. Repeal of McCarran-Ferguson would not change the states' role as the primary regulators of insurance. Even after repeal, the states would still be able to regulate insurance -- even in ways that would harm consumers -- provided they clearly articulated a policy to displace competition and actively supervised the results.

In some states, the present legislative and regulatory framework probably would satisfy the "state action" standard. Elsewhere, however, the regulatory framework might not qualify and "state action" immunity would not attach. If those states wished to protect the anticompetitive activities that now occur, they would have to amend their regulatory frameworks -- and do so in public. In the process, they might have to confront openly the question of why insurance companies should be permitted to fix prices -- a practice ordinarily regarded as harmful. Whatever the result, consumers would gain from a public review of this question.

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[13] Southern Motor Carriers Rate Conference, Inc. v. United States, 471 U.S. 48 (1985).

Today, insurers no longer focus very much on the sort of federalism argument that was made in 1944. Playing on the public's increasing and justified aversion to excessive federal regulation, they suggest that repeal would lead to comprehensive federal control. But they offer no support for this specter, and I would be the first to oppose it. Of course, repeal would not necessarily lead to creation of a federal insurance regulatory agency, and I would not expect Congress to embark on such an ill-advised enterprise. Repealing McCarran-Ferguson would neither prejudice state regulation nor necessitate federal regulation, and continued existence of the exemption is simply not essential as a matter of federalism.

"Ruinous Competition"

There is another argument that insurers make against repeal. They claim that antitrust exposure will prevent insurers from engaging in legitimate cooperative activities. I find this argument especially wrong-headed. Perhaps because insurers have been free of antitrust scrutiny for so long, they have a warped view of its strictures. But as the leader of one of the two federal agencies that enforces the antitrust laws, I can assure you that the joint activity argument is a straw man. Enforcement agencies and courts are well aware that some forms of joint action enhance rather than restrict competition, and are quite sophisticated at distinguishing harmful from beneficial agreements.

Mr. Chairman, you can expect insurers to claim that they need immunity in order to engage in joint rate-making. They will say that price fixing preserves insurer solvency and assures that money will be available to pay off policy-holders. But numerous other kinds of firms make risky contractual commitments and manage to pay them off without setting up cartels. Moreover, state legislatures have adequate authority to address any genuine solvency problems by auditing the companies, requiring loss reserves, and establishing state guarantee funds.

Claims that competition will hurt policyholders are bogus. The evidence from other industries that have been deregulated and exposed to application of the antitrust laws demonstrates that consumers benefit from competition. The Commission is particularly familiar with the recent experience of the health professions, which have been subject to market forces for only a decade. Although doctors may be working harder for a bit less money, they are by no means starving. More importantly, their patients still receive good care, and are able to choose from a far broader array of price and service options than before.

In recent years, many states have recognized the benefits that flow from competition, and have given their insurers more freedom to set their own rates. Indeed, in Illinois, rate bureaus are limited to statistical collection and analysis. From listening to the insurers, you might suppose that insurers have gone bankrupt when deprived of their cartel, but the National Commission for the Review of Antitrust Laws and Procedures found no harmful effects.14/ Competition poses no risk to the solvency of the vast majority of insurers.

So, insurers now make an alternative argument and assert that they must pool loss data to make actuarially accurate projections. As best I can determine, their claim may well be true. Antitrust law, however, poses no impediment to the pooling of loss data. Agreements among competitors that promote competition are not unlawful.15/ The problem arises when insurers go beyond collecting and aggregating loss data, and collectively determine rates or coverages to be offered. It is such joint rate-setting or determination of coverage, and not joint data collection, that restricts competition and harms consumers. I simply do not understand why insurers cannot employ jointly collected data to determine their own rates and coverages individually.

14/ NCRALP Report, at 233.

15/ *E.g.*, Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. 1 (1979).

Ever since passage of the Sherman Act in 1890, the operative premise underlying our antitrust laws has been that free markets work much better than heavily regulated markets. Firms that want special treatment for their industry should have to justify in detail any exception to the general rule. Insurers have not made a persuasive case over the past 40 years, and I doubt they will be able to do so this year. It is the duty of Congress to correct the mistaken notion that competition principles do not apply to the insurance industry.

Conclusion

There is broad agreement across the philosophical spectrum that exemptions from the antitrust laws are undesirable. As I mentioned at the beginning of my testimony, I wholeheartedly subscribe to the premise that, in the words of the Supreme Court, "unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress."[16] Perhaps even more importantly, as Mr. Justice Black went on to observe, free and unfettered competition provides "an environment conducive to the preservation of our democratic political and social institutions."[17] Free markets are the foundation of both our economic prosperity and our political freedom. We make exceptions to the laws that ensure free markets at our peril.

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[16] Northern Pacific Railway v. United States, *supra*, 356 U.S. at 4.

[17] *Id*.

The insurance exemption from the antitrust laws, in particular, has come under increasing attack. Experience and logic demonstrate that the exemption is adverse to consumers and is unnecessary to protect legitimate industry conduct. Eight years ago, the National Commission for the Review of Antitrust Laws and Procedures called for repeal of the exemption. More recently, so has the National Association of Attorneys General. The Supreme Court has done about as much as it can to limit the scope of the McCarran-Ferguson Act. The time has come for Congress to act.

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

OFFICE OF
THE CHAIRMAN

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March 30, 1987

The Honorable Joseph R. Biden, Jr.
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On February 18, I testified before the Judiciary Committee concerning S. 80, a bill that would repeal the McCarran-Ferguson Act.

During the hearing, Senator Humphrey asked me for examples of harmful conduct by insurers that the McCarran-Ferguson Act had protected from antitrust challenge. I mentioned a case involving an alleged conspiracy among insurers to deny compensation for lost future earnings. This case was dismissed because of the McCarran-Ferguson Act. It was not, however, as my response suggested, a Commission case or investigation, but rather was a private action. Grant v. Erie Insurance Exchange, 542 F. Supp. 457 (M.D.Pa. 1982), aff'd, 716 F.2d 890 (3rd Cir.), cert. denied, 464 U.S. 938 (1983). Nevertheless, the case still stands as an example of possibly anticompetitive behavior protected from antitrust scrutiny by the McCarran-Ferguson Act. Moreover, I note that our Bureau of Competition recently closed a non-public investigation of possibly harmful joint activity by insurers because the Bureau determined that the conduct was protected by the McCarran-Ferguson Act immunity.

Thank you for this opportunity to clarify the record. Please let me know if I may be of any further assistance.

Sincerely,

Daniel Oliver
Chairman

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

OFFICE OF
THE CHAIRMAN

April 20, 1987

The Honorable Joseph R. Biden, Jr.
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I welcomed the opportunity to testify before the Judiciary Committee on the desirability of repealing the McCarran-Ferguson Act, and I am pleased to respond to the questions raised in your recent letter. The following answers reflect my own views, and not necessarily those of the Commission or any of my colleagues. As I noted in my testimony, however, a majority of the Commission supports repeal of the antitrust immunity provision of the McCarran-Ferguson Act.

Question 1: Are you familiar with the report of the tort policy working group which was released in February, 1986? Were you a part of that task force, which was headed by Richard Willard, Assistant Attorney General for the Civil Division?

I am familiar with the report of the tort policy working group. I was not a member of the working group, nor was any other member of the Commission or our staff.

Question 2: That report summarily dismisses McCarran-Ferguson Act repeal or reform as part of the solution to the so-called liability crisis. However, in 1977 and again in 1979, the Antitrust Division strongly recommended that repeal, -- or at the very least, limitation of the McCarran Act's antitrust immunity for the insurance industry would be in the public interest. What accounts for the marked difference in views?

I do not think there is a "marked difference in views" among the cited studies.

The 1977 Justice Department Report on "The Pricing and Marketing of Insurance" and the 1979 Report of the National Commission for the Review of Antitrust Law and Procedures were both intended to address the question of whether the antitrust immunity provision of the McCarran-Ferguson Act should be repealed, and each concluded that it should. Neither was concerned with any so-called liability crisis.

The Tort Policy Working Group, on the other hand, was asked to report on the causes, extent and policy implications of the "crisis in liability insurance availability and affordability." It did not review and took no position on the insurance industry's antitrust immunity, although it noted that the immunity had been criticized for a variety of reasons, citing the 1977 Justice Department report. Report of the Tort Policy Working Group, at 27 n.16. It also observed that it is inconsistent to blame "excessive competition" for the current problems of the insurance industry, and also to propose repeal of the McCarran-Ferguson Act, which should increase competition in the industry, as the solution for those problems. Id. at 27.

In supporting repeal of the McCarran-Ferguson Act, I do not mean to suggest that this would dramatically affect the availability or price of liability insurance generally; it would not. Nonetheless, I believe that repeal would benefit consumers by making it possible for the antitrust enforcement authorities to put an end to anti-consumer, joint activities in the insurance industry, whether affecting the price and availability of liability insurance or any other type of insurance, to the extent the activities were not authorized and actively supervised by the states.

Question 3: No one made mention of excessive competition in 1979, when the first signs of a crisis in the cost and availability of liability insurance could be clearly seen. Although the National Commission for Revision of the Antitrust Laws acknowledged that the insurance industry was competitively structured, the recommendation was made in no uncertain terms that the broad antitrust immunity granted by McCarran-Ferguson be repealed. It was stated that the exemption served no federal or state objective, was not necessary for the effective functioning of the industry and permitted insurers and state regulators to avoid any inquiry into the appropriate limits that should be placed on insurance companies' collective activities.

Question 4: Do you believe that McCarran-Ferguson serves any federal or state regulatory objective?

No. As I stated in my testimony, there is no conflict between state regulation of insurance and federal antitrust enforcement. If a state clearly articulates a policy to displace competition, and actively supervises the anticompetitive activities that it authorizes, the resulting conduct is exempt from antitrust scrutiny under the state action doctrine. A special, much broader exemption for the insurance industry -- as is established by the McCarran-Ferguson Act -- is completely unnecessary.

Nor does the McCarran-Ferguson Act serve any federal regulatory objective. Indeed, I do not see any appropriate federal regulatory role with respect to the business of insurance. The McCarran-Ferguson Act should be repealed in order to encourage increased competition in the insurance industry, not as a preamble to stifling the existing competition through federal regulation.

Question 5: Do you believe that any limits should be placed on the collective or collaborative activities engaged in by insurance companies?

Yes. The antitrust laws should limit the collective activities of insurance companies just as they limit the collective activities of other companies. As my testimony indicated, however, even without the McCarran-Ferguson Act, not all joint insurer activity would be illegal. Joint conduct that enhanced efficiency without restricting output would not violate the antitrust laws. On the other hand, joint conduct that hurt consumers by raising prices or restricting the available lines of insurance or terms of coverage would be, and should be, illegal. I see no reason why these rules cannot apply to every company, insurer or not.

I appreciate this opportunity to continue our discussion of the McCarran-Ferguson antitrust exemption for the insurance industry. Please let me know if I may be of any further assistance.

Sincerely,

Daniel Oliver

Daniel Oliver
Chairman

Senator **Metzenbaum**. We are going ~~to~~ hear ~~from~~ Mr. Rule first before we take any committee questions.

Mr. Rule, we are happy to have you with us here this morning.

Mr. **Rule**. Thank you, sir. Thank you, Mr. chairman, members of the committee. I am pleased to appear this morning to discuss the proposed repeal of the exemption from the antitrust laws that is contained in the McCarran-Ferguson Act.

The antitrust laws embody our fundamental national policy of free market competition. In the absence of compelling circumstances, the Department is opposed to the enactment or continuation of either general or industry-specific exemptions from those laws.

It is certainly appropriate to reexamine such exemptions from time to time to determine whether their justifications remain valid, discern the competitive costs they may be imposing on society, and consider any costs that might attend their repeal.

We endorse the committee's decision to undertake at this time such a reexamination of the antitrust exemption currently enjoyed by the business of insurance. We believe the burden of persuasion should be on those who advocate the perpetuation of the antitrust immunity.

I would note at the outset that we are discussing the repeal of a longstanding industry-specific antitrust exemption rather than the enactment of a new one. As I will discuss in a moment, we feel that there would be no justification today for the enactment of a new antitrust exemption for the business of insurance.

There are, however, possible costs associated with repealing the one we have, costs that it may well be necessary or appropriate to bear, but costs nonetheless. The possibility of having to incur such costs when an antitrust exemption finally is repealed is one very good reason not to create questionable exemptions in the first place.

In response to the desire to keep the statement short, I would like to summarize my full statement that I understand will be in the record by making four points, Mr. chairman.

First, putting aside the question of repealing that part of the McCarran-Ferguson Act that provides an antitrust exemption, the Department of Justice strongly opposes any legislation that would change or even appear to change the traditional relationship between the States and the Federal Government in regulating insurance.

We believe there has been no showing that there is a need for federal regulation in this area. The States, as you, Mr. chairman, have pointed out, are doing a good job. They have moved towards less regulation, more competition, and I think that is a good thing.

By repealing those first two sections of the McCarran-Ferguson Act—that is, those sections that clarify the States' power to tax and regulate insurance and that require explicit preemption of State regulation of insurance by Federal law—S. 80 unnecessarily risks changing the traditional relationship between States and the Federal Government in this area and risks creating a wedge for Federal intervention. Therefore, for that reason, we do not believe that those first sections of the McCarran-Ferguson Act should be repealed.

Second, if the question before the committee today were whether to enact a new antitrust exemption for the insurance industry, my answer would be rather simple and it would be a resounding no.

The insurance industry has no inherent characteristics that require its protection from competition. Moreover, both substantive antitrust analysis and the State action doctrine have evolved to a point today that participation in the various forms of cooperative and governmentally-sanctioned aspects of the insurance industry should not create antitrust liability for insurers.

Third, and unfortunately, for the past 40 years the insurance industry has been exempt from the antitrust laws, so the answer to the question actually being considered by this committee today is not so simple, nor is it so clear-cut.

The various cooperative and governmentally-sanctioned aspects of the industry would suddenly be subject to antitrust challenges. There are two potential adverse effects that I believe must be considered before proceeding with the repeal of the Act, and I think they can be addressed, but they must be considered and taken into account.

First, States may step up regulation, step up their interference with competitive market forces in order to perfect the industry's State action defense. As the Chairman of the FTC has pointed out, the State action defense has evolved in a way that does not require compulsion by the States, but it still apparently requires more than is required under the McCarran-Ferguson Act, and it would be a shame if this Act that was designed to increase competition had the effect of actually increasing regulation and decreasing competition and competitive market forces.

Second, and perhaps more importantly, although I think that ultimately these issues would be resolved through litigation and resolved favorably to the insurance industry, the legality of various types of beneficial conduct, cooperative conduct, would be uncertain at the outset.

This uncertainty in litigation could raise the cost of providing insurance and, in the near term, perhaps could exacerbate the current crisis in liability insurance. I do not know the magnitude of those costs or those problems. I think the burden is on those who would continue the exemption to come forward with evidence on those costs.

I also do not have an answer right now as to how to reduce those costs, but I pledge the cooperation of the Division to help the committee to find an answer to resolve and at least reduce those costs.

My fourth and last point is that even assuming the above problems can be resolved, and while recognizing that repeal of the antitrust exemption for the insurance business should generate benefits for consumers, I cannot predict the magnitude of those benefits.

I also cannot represent that repeal will resolve the current crisis in the availability and affordability of liability insurance because that crisis appears to be due to other factors.

Even with an antitrust immunity, the insurance industry, particularly the property and casualty parts of the business, is so structured that collusion successfully to fix prices would be extremely difficult.

The true cause of the current crisis, particularly in the property and casualty lines, appears to have little to do with the McCarran-Ferguson Act, but instead appears to be a result of a trend toward increasing pay-outs and increasing liability on the part of insurance companies, and perhaps even more importantly, to increasing variability—that is, unpredictability of risk—associated with that liability.

In conclusion, Mr. Chairman, it is my hope that we can quickly resolve the question of the antitrust exemption for the insurance industry. I hope we can do that by developing a statute that repeals only the antitrust exemption in a way that eliminates or substantially reduces the potential adverse effects of repeal.

I hope that then we can all join together and turn to resolving the true causes of concern in the insurance industry and among the consuming public; that is, primarily problems in the tort law area.

Thank you. That concludes my remarks and I will be happy to answer any questions the committee might have.

Senator **Metzenbaum**. Thank you, Mr. Oliver and Mr. Rule. Both of your full statements will be included in the record.

[Prepared statement follows:]

STATEMENT OF

CHARLES F. RULE
ACTING ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

S. 80

A BILL TO REPEAL THE McCARRAN-FERGUSON ACT

ON

FEBRUARY 18, 1987

Mr. Chairman and Members of the Committee:

I am pleased to appear this morning to discuss the proposed repeal of the exemption from the antitrust laws that is contained in the McCarran-Ferguson Act. The antitrust laws embody our fundamental national policy of free market competition. In the absence of compelling circumstances, the Department is opposed to the enactment or continuation of either general or industry-specific exemptions from those laws. It is certainly appropriate to reexamine such exemptions from time to time to determine whether their justifications remain valid, discern the competitive costs they may be imposing on society, and consider any costs that might attend their repeal. We endorse the Committee's decision to undertake at this time such a reexamination of the antitrust exemption currently enjoyed by the business of insurance. We believe the burden of persuasion should be on those who advocate the perpetuation of antitrust immunity.

I would note at the outset that we are discussing the repeal of a long standing, industry-specific antitrust exemption rather than the enactment of a new one. As I will discuss in detail in a moment, we feel that there would be no justification today for the enactment of a new antitrust exemption for the business of insurance. There are, however, possible costs associated with repealing the one we have--costs that it may well be necessary or appropriate to bear, but costs nonetheless. The possibility of having to incur such costs when an antitrust exemption finally is repealed is one very good reason not to create questionable exemptions in the first place.

Prior to 1944, regulation of insurance was exclusively the province of the states, under the prevailing view that insurance was not "commerce." In that year the Supreme Court decided the South-Eastern Underwriters case 1/ and held that the insurance business was within the regulatory power of Congress under the commerce clause and thus was subject to the antitrust laws. South-Eastern Underwriters was perceived as posing three threats to state insurance regulation. First, it was feared that the commerce clause would unduly limit the power of the states to regulate and tax on the theory that regulation and taxation of insurers engaged in interstate commerce imposed an impermissible burden on that commerce. Second, there was apprehension that state regulation of insurance rates would be held invalid because of its inconsistency with the Sherman Act. Finally, there was a concern that efficiency-enhancing joint insurer activities would be invalidated under the antitrust laws.

Congress enacted the McCarran-Ferguson Act to remove these perceived threats. Section 1 of the Act declares that

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1/ United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944).

regulation and taxation of the business of insurance by the states is in the public interest and that silence on Congress's part shall not be construed to impose any barrier to such state regulation or taxation. Section 2(a) provides that the business of insurance and those engaged therein shall be subject to state laws relating to the regulation and taxation of insurance. Section 2(b) reinforces that statement by declaring that no congressional enactment shall be construed to "invalidate, impair, or supersede" any state law enacted for the purpose of regulating or taxing the business of insurance unless that congressional enactment specifically relates to the business of insurance. Finally, sections 2(b) and 3(b) of the Act declare that, except for agreements to boycott, coerce or intimidate or acts of boycott, coercion or intimidation which remain fully subject to the Sherman Act, the "business of insurance," to the extent it is regulated by the states, is exempt from the antitrust laws.

S. 80 would repeal the McCarran-Ferguson Act in its entirety. It would repeal the Act's explicit antitrust exemption provisions. It also would eliminate those sections of the Act that confirm the ability of the states to regulate and tax the business of insurance and that govern the construction of other federal laws that do not specifically relate to the business of insurance.

We are not certain whether S. 80 was drafted with the intention of doing anything more than repealing the antitrust exemption currently enjoyed by the business of insurance to the extent that business is regulated by state law. On the basis of Senator Metzenbaum's statement on the occasion of the bill's introduction, it does not appear that S. 80 is intended to deny states the ability to regulate the insurance industry. Nor does S. 80 appear designed to herald any new federal regulation other than the full applicability of the federal antitrust laws to the business of insurance, just as they apply to other businesses.

I will turn to the merits of repealing insurance's antitrust exemption in a moment. Initially, I want to express concern that by repealing the McCarran-Ferguson Act in its entirety S. 80 could have unintended effects on state regulation of insurance. While states appropriately are examining the way in which they regulate the business of insurance, and moving toward less regulatory regimes that recognize the benefits of competition, the authority to regulate should remain at the state level. The Department would be very much opposed to any movement, or appearance of movement, toward the federalization of insurance regulation. Repeal of anything other than the explicit antitrust exemption in the McCarran-Ferguson Act could create confusion and litigation concerning state insurance regulation and taxation and the supremacy and so-called dormant commerce clauses of the Constitution.

Turning to antitrust issues, the Department has always been and remains opposed to general or industry-specific antitrust exemptions in the absence of a strong showing by those who advocate immunity of an actual or potential conflict between the antitrust laws and some supervening societal goal. The antitrust laws embody the nation's fundamental economic policy of competition. Competition maximizes consumer welfare and the efficient allocation of societal resources.

At least in recent years, the antitrust enforcement agencies and the courts have interpreted the antitrust laws in ways that do not inhibit any practice that is not truly anticompetitive. Such recent Supreme Court decisions as General Dynamics, 2/ GTE Sylvania, 3/ and Broadcast Music 4/ make clear that sound economically-based analysis is required before an antitrust challenge will be sustained. In those and other decisions the courts have exhibited a reluctance against over-zealous application of the per se rule to alleged restraints of trade the actual competitive effects of which are ambiguous. While Congress in recent years has recognized the need for certain clarifications of the antitrust laws and for

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2/ United States v. General Dynamics Corp., 415 U.S. 486 (1974).

3/ Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

4/ Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1979).

moderation of their penalties, 5/ the inherent flexibility of those laws and the importance of the competitive process they protect argue strongly against antitrust exemptions that are not clearly and convincingly justified.

Were an antitrust exemption for the business of insurance a matter of first impression today, such an exemption could not, we believe, be justified. First, there is no inherent need for a special statutory antitrust exemption in order for the states to regulate the business of insurance, or for that matter any other business. Under the "state action doctrine," which was undeveloped in 1945 but has been the subject of many subsequent Supreme Court decisions, a state effectively may immunize what otherwise might be an unlawful restraint of trade through a clearly articulated, affirmatively expressed state policy to displace competition, coupled with active supervision of any private conduct that may be involved.

Second, the application of the antitrust laws to potentially efficiency-enhancing joint activities among competitors has become much more predictable--and much more favorable to such activities--than it was at the time the McCarran-Ferguson Act was enacted. Some forms of joint activity that might have been condemned under overly-broad interpretations of the antitrust laws are now clearly

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5/ See, e.g., the Export Trading Company Act of 1982, the National Cooperative Research Act of 1984, and the Local Government Antitrust Act of 1984.

permissible. Antitrust rules, as the courts articulate them today, are firmly based upon principles of sound economics and can be adapted to any industry. It is possible, as I will discuss in a moment, that some legitimate joint insurer conduct might superficially be perceived as raising antitrust risks in the absence of statutory immunity, and thus that some clarification of the antitrust laws might be appropriate if the current McCarran-Ferguson exemption were repealed. Such a clarification, however, would be a far cry from exempting any truly anticompetitive conduct from the application of those laws.

While we therefore think that the record would be lacking for the creation today of a new exemption for the business of insurance like that contained in the McCarran-Ferguson Act, the fact of the matter is that such an exemption has been on the books for 40 years, and the system of state regulation that it complements has been around even longer. Thus, repealing the exemption involves more than just cleaning up Title 15 by removing any antitrust exemptions that we would not enact today. Relevant inquiries include whether there would be any significant costs associated with repealing insurance's antitrust exemption, and if so whether those costs would be more than outweighed by the benefits of doing so. We perceive some uncertainties associated with both of these issues that we believe warrant the Committee's attention.

Turning first to possible costs of repeal, some uncertainty exists as to whether repealing insurance's antitrust exemption might indirectly and adversely affect the manner in which states choose to regulate insurance. Such an effect might be the result of a perception that the state action doctrine, even as understood today, would not immunize some joint insurer conduct under some forms of state regulation, particularly state regulation that is neutral as to whether insurers participate in joint activity or not.

As I indicated above, there are two tests that must be met for state action immunity to be afforded to an alleged restraint on competition. First, the restraint must be the product of a "clearly articulated and affirmatively expressed" state policy to displace competition. Second, the state must actively supervise any private anticompetitive conduct. 6/ In its 1985 decision in Southern Motor Carriers, 7/ the Supreme Court held that a state need not "compel" private anticompetitive conduct in order for such conduct to be immune from antitrust liability as state action. In that case, state regulation of collective ratemaking by intrastate motor carriers was considered sufficient to establish the state

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6/ California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980), quoting City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389, 410 (1978) (opinion of Brennan, J.).

7/ Southern Motor Carriers Rate Conference, Inc. v. United States, 471 U.S. 48 (1985).

action immunity. While Southern Motor Carriers suggests that under the state action doctrine at least some forms of state insurance regulation would protect concerted decisions among insurers from antitrust liability, states may regulate some insurer conduct in a manner that is sufficient to trigger the McCarran-Ferguson exemption, but not sufficient to provide state action immunity. Whether any particular, overall state regulatory scheme would satisfy the two-pronged test for state action immunity described above ("clear articulation," "active supervision") could be open to question.

The appropriate response to this uncertainty, of course, may be that the requirements for state action immunity under Southern Motor Carriers are the very tests that should apply to state insurance regulation, just as they apply to any other industry. One can well argue that any alleged competitive restraint among insurers that is sufficiently "private" in nature to be unprotected by the state action doctrine should be subject to antitrust scrutiny. There is a possible problem here, however. It is conceivable that if the McCarran-Ferguson antitrust exemption were repealed, at least some states might react by adopting less innovative, more anticompetitive approaches to insurance regulation in order to ensure the applicability of the state action doctrine. That is, some current state regulation may be perceived as too permissive to trigger the state action defense--i.e., not a sufficiently clear expression of a policy to displace competition--and thus might be replaced by a more anticompetitive regulatory scheme in order to guarantee antitrust immunity. As Senator Metzenbaum noted in introducing S. 80, the recent trend in state regulation has been to permit freer competition among insurers. We would hope that that trend would not be adversely affected by a change in federal law that induces attempts to fortify state regulation in order to preserve antitrust immunity.

Some uncertainty also may exist with respect to the bounds of legitimate joint insurer activities related to prices. While it is true that antitrust law has evolved in recent years to avoid per se condemnation of joint activities that are on balance procompetitive--even in the face of spurious arguments that they constitute price fixing [8]--some collective activities that promote competition among insurers might be unduly deterred by perceived antitrust risk. Many desirable joint activities protected by the McCarran-Ferguson Act today are at least indirectly related to price, and might be subjected to antitrust challenges if insurance's antitrust exemption were simply repealed. While I believe those practices ultimately would be vindicated as in the interests of consumers, that vindication might take time and engender some significant costs.

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[8] See Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., *supra* note 4.

This uncertainty might be reduced by a repeal of the McCarran-Ferguson Act antitrust exemption that also clarifies those legitimate cooperative activities that would not be unlawful under the antitrust laws. This is the approach, for example, of Senator Simon's proposal, introduced in the last Congress as S. 2458, and similar in concept to a proposal considered by the National Commission for the Review of Antitrust Laws and Procedures in 1979. It would preserve an exemption for certain specified joint insurer activities--for example, collecting and disseminating loss data, preparing pure premium rate data and policy forms, and conducting various other forms of research and information distribution.

There are, of course, potential difficulties with this approach. It may be difficult to describe in sufficient detail those cooperative arrangements that are legal under the antitrust laws. Too broad a description could protect anticompetitive conduct, while too narrow a description could be inadequate to eliminate the uncertainty. It also might be difficult to develop an exhaustive list of legitimate arrangements.

Antitrust uncertainty might be further reduced by phasing in application of the antitrust laws to the business of insurance, along the conceptual lines of sections 1(b) and 2 of S. 80. While such provisions could provide an appropriate adjustment period, it is not clear whether outstanding legal issues would be decided or even justiciable until after such a phase-in was complete.

There are also uncertainties associated with the potential benefits--essentially the promotion of competition--that would be derived from repealing insurance's antitrust exemption. Repealing that exemption may not make insurance significantly more widely available at lower prices. In particular, repeal does not seem likely to solve the crisis in certain lines of property/casualty insurance. We have not seen any direct evidence that anticompetitive collusion has produced this crisis, and the circumstantial evidence suggests that collusion is not the cause.

The structure of the property/casualty insurance industry is conducive to competition, not collusion. Moreover, as Senator Metzenbaum noted when introducing S. 80, state rate regulation that may have facilitated collusion by requiring prior approval of rates and discouraging deviations from the rates established by rating organizations has largely been supplanted by state laws that allow free play for price competition.

The United States property/casualty insurance industry includes a very large number of underwriters--in the neighborhood of 1,000. 9/ No single firm or small group of firms dominates this industry: the eight largest property/casualty companies collectively account for only about a third of direct premiums written by property/casualty

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9/ Best's Executive Data Service A2-99-99 (1986).

underwriters. Property/casualty underwriters are diverse in their methods of doing business: for example, some sell through agents, while others are "direct writers" who deal with insurance consumers through their own employees. While not all companies do business in all states and most companies do not write all types of property/casualty coverage, we are not aware of any significant regulatory or other barriers that would prevent companies from moving quickly from one type of property/casualty insurance to another or from one state to another.

In these circumstances we would not expect to find effective collusion. Even if a substantial number of firms in a particular state could reach accord as to price by agreeing to adhere to the pricing schedule filed by a rating organization, it would be difficult for those firms to prevent outsiders from rapidly entering the market and offering a lower price to insurance consumers. Moreover, while defections from the collusive agreement would be easy to detect because of state laws requiring the filing of all rates, there is no readily apparent means of preventing those defections, at least in the large number of states that permit new rates to be used as soon as filed or even prior to filing.

Hence it seems highly probable that the property/casualty industry is in fact competitive, and that collusion is not responsible for the availability and affordability crisis in certain lines of insurance. While the cause of the crisis is not entirely clear, it seems likely that the increase in the level of casualty loss payouts and expenses in these lines, and the increase in the variability of those losses and expenses, are major contributing factors to the crisis. If variability (that is, "risk") is very substantial, the premiums required to maintain solvency requirements might be so high that coverage would be unattractive to potential insureds. There would then appear to be an affordability crisis in the affected lines. Should variability be so great as to exceed the ability or willingness of insurers to cope with it, coverage might be unavailable at any price.

To summarize, Mr. Chairman, the Department of Justice remains opposed to the enactment of new antitrust exemptions or the continuation of those that may be outdated and unnecessary without a strong showing by the advocates of immunity that they are justified. We believe that the current, broad McCarran-Ferguson exemption for the business of insurance may well have outlived its usefulness, and endorse the Committee's inquiry into the continuing need for it, at least in its present form. We believe, however, that there are some uncertainties associated with both the costs and benefits of repealing or modifying this longstanding exemption that warrant the Committee's inquiry and attention. We will be most interested in the record that evolves before the Committee, and we hope to work further with the Committee in assessing what kind of legislation would be best at this time.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions you or any members of the Committee may have.

Senator Metzenbaum. The Chair notes that normally the committee would operate with a 10-minute period for questions. By reason of the number of witnesses that we have scheduled, we will operate on a 5-minute rule, but we will have as many rounds as members feel necessary.

Mr. Rule, your testimony says to me we basically support repealing the McCarran-Ferguson Act if uncertainty about the legality of certain key socially-beneficial joint activities of the industry can be resolved. Is that a fair characterization?

Mr. Rule. I think that is a fair characterization, yes, sir.

Senator Metzenbaum. In 1977, a Justice Department task force appointed under President Ford concluded that the antitrust laws would not prohibit pooling of information about losses, a necessary trending of future losses on a composite basis by an independent advisory organization, and voluntary risk-sharing agreements that were necessary to the conduct of business or served some other legitimate business purpose without substantially lessening competition.

Do you agree basically with that conclusion, Mr. Oliver, or did I read it so rapidly that it is a little confusing?

Mr. Oliver. Sir, I think that the law has evolved since that report was written. My own feeling is that probably no special exemptions are required today, if that is your question. I am not sure I understood your question.

I believe that the activities that the insurance companies would want to engage in that are pro-competitive, they could engage in without any special legislation on the part of Congress; that the antitrust laws would not prohibit those activities.

Senator Metzenbaum. As the author of the bill, I am frank to say that I am perfectly amenable to recognizing the problem that some have raised on this issue, and if it needs discussion or clarification, that does not give me any concern.

Mr. Rule, did you care to add anything to what Mr. Oliver has said?

Mr. Rule. I would agree with what the chairman has said, and my point is not that ultimately after litigation these various beneficial, cooperative activities would be found illegal.

I have a great deal of confidence in the antitrust laws and the way they have evolved particularly over the last 10 to 15 years and that the courts would recognize the benefits of these various cooperative activities.

The concern is getting from here to there and how long it will take, the costs associated with the uncertainty and the litigation in the intervening period of time. That is why from our standpoint it seems appropriate to consider those costs that would attend the repeal of the McCarran-Ferguson Act and try to do something to mitigate, if we cannot simply eliminate those costs.

Senator Metzenbaum. Or legitimatize the activities without requiring a court case in order to arrive at that conclusion.

Mr. Rule. Yes, sir.

Senator Metzenbaum. I would be happy to work with you along that line.

Mr. Oliver, do you think consumers have been protected from anti-competitive and unjustified insurance rates by the current system of State regulation of insurance coupled with antitrust immunity?

Mr. OLIVER. Senator, I do not believe that I can answer that question because the Federal Trade Commission, as you know, is not allowed to study the business of insurance and, to the best of my knowledge, has not for years. So I do not believe I can give you a knowledgeable answer to that question.

I would only assume myself that without competition acting in the marketplace for the benefit of the consumer, I would be skeptical that in every case consumers had gotten the benefit of the lowest possible rates that competition might produce for them.

Senator METZENBAUM. Let me ask you a hypothetical question. If you are watching TV and you see an insurance advertisement that you just think is openly deceptive, can the FTC sue to stop such practices today?

Mr. OLIVER. I would suppose if that is the business of insurance, Senator, the answer would be no.

Senator METZENBAUM. The answer would be no. I guess it would be the business of insurance.

Without asking you to comment on the merits of the matter, is the FTC at the present time engaged in litigation with the title insurance industry over alleged collusion in the setting of rates?

Mr. OLIVER. We have an action against title insurance companies, Senator, but as you know, I am not allowed to discuss it.

Senator METZENBAUM. And I would not ask you to. Has the McCarran-Ferguson Act been raised as a defense in that case, if you know?

Mr. OLIVER. I do not know, Senator.

Senator METZENBAUM. I see my time has expired.

Senator Thurmond.

Senator THURMOND. Thank you very much.

I want to set out for just a few moments the position briefly. As I understand it, the FTC position is this:

> The McCarran-Ferguson Act proposed to ameliorate its adverse effects by conditioning immunity on the existence of State regulation. Unfortunately, the courts have interpreted the Act's "regulated by State law" requirement very broadly, so that even a cameo appearance by the State will cloak private action with immunity. Thus, some cases have held that the mere existence of a general scheme for insurance regulation constitutes sufficient State involvement to immunize a broad range of practices, including activities that the State has never directly authorized or even considered.

Is that about the position of the FTC?

Mr. OLIVER. That is correct, Senator, although I should clarify and say that is my position and not necessarily the position of the other commissioners. The statement is mine. A majority of the commissioners agree that the antitrust immunity granted by McCarran-Ferguson should be repealed, but the statement is my statement.

Senator THURMOND. Now, the Justice Department, to briefly summarize in one paragraph their position:

> Initially, I want to express concern that by repealing the McCarran-Ferguson Act in its entirety S. 80 could have unintended effects on State regulation of insurance.
>
> While States appropriately are examining the way in which they regulate the business of insurance and moving to less regulatory regimes—they recognize the benefits of competition—the authority to regulate should remain at the State level.

> The Department would be very much opposed to any movement or appearance of movement toward the federalization of insurance regulation. Repeal of anything other than the explicit antitrust exemption in the McCarran-Ferguson Act could create confusion and litigation concerning State insurance regulation and taxation and the supremacy and so-called dormant commerce clauses of the Constitution.

In brief, does that summarize your position of the Justice Department?

Mr. RULE. Yes, sir, with the addition that we would support repeal of that exclusive antitrust exemption as long as we can somehow ameliorate the adverse effect on beneficial cooperative activity.

Senator THURMOND. What I am trying to do is say in as few words as I can the FTC position and the Justice Department position, and now the State insurance commissioners, and this is about as I understand their view:

> The statement issued by Chairman Metzenbaum characterizes Senate Bill 80 as primarily a measure seeking repeal of an antitrust immunity statute. This characterization overlooks the expressed language of Section 2(a) of McCarran, which is, and I quote, "The business of insurance and every person engaged therein shall be subject to the laws of the several States which relate to the regulation of taxation of such business." By adoption of McCarran, Congress concluded that the public would be better served if regulatory authority over the business of insurance were vested in the individual States. Total repeal of McCarran as proposed by Senate Bill 80 is inherently linked with the fundamental issue of State versus Federal regulation of insurance. To suggest that State regulation of insurance will not be impacted by repeal is to ignore the significance of the regulatory vacuum and the uncertainty that would be created.

As I understand it, that is the position of the State insurance commissioners.

Now, I have two questions here that I would like for you to address. Has the Justice Department found any evidence that anticompetitive conduct has caused a shortage of property and casualty insurance?

Mr. RULE. No, sir, we have not.

Senator THURMOND. Now, I want to ask you both this question. In your view, how would repeal of the McCarran-Ferguson Act affect the authority or the role of State insurance regulators? Mr. Oliver, you can answer that first.

Mr. OLIVER. Senator Thurmond——

Senator THURMOND. Did you understand the question?

Mr. OLIVER. Yes, sir. I think it would not affect the role of State regulation so long as the State did proceed to regulate in a manner that meets the so-called State action doctrine. States can regulate any industry and, in a sense, exempt that industry from the nation's competition laws by making an affirmative statement that they will displace competition and then by supervising the activities in question.

So the States would still be free to regulate, but they would have to do it in an affirmative manner.

Senator THURMOND. Mr. Rule, my time is about up, but go ahead. Would you answer that question?

Mr. RULE. Yes, sir.

Senator THURMOND. You understand the question?

Mr. RULE. Yes, sir. From our point of view, it is imperative that if an attempt is being made to repeal the antitrust exemption that

that is all you repeal. If you repeal the other two parts of the Act, it would create uncertainty and confusion.

It could lead to problems in terms of the scope of State insurance regulation, and for that reason we do not think that those parts of the McCarran-Ferguson Act that clarify the States 'role in regulation should be affected or should be tampered with.

If, however, you only repeal the antitrust exemption, I do not believe that that alone would improperly impinge upon the States' ability to regulate insurance. Frankly, there are a whole range of areas that the States traditionally regulate, businesses that the States traditionally regulate, where the antitrust laws apply and where both the antitrust laws and State regulation co-exist in harmony, and I think that would be the case in insurance as well.

Senator THURMOND. I want to thank you both.

My time is up. Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you.

Senator Heflin, we are happy to have you with us this morning.

Senator HEFLIN. Mr. Rule, in the last session of Congress the Department of Justice came up with a number of recommendations pertaining to revision of the antitrust laws. I believe that included therein were the Merger Modernization Act, Interlocking Directorate Act, Foreign Trade Improvements Act of 1986, Promoting Competition in Distressed Industries Act, and Antitrust Remedy Improvement Act of 1986.

How would the repeal of the McCarran-Ferguson Act relate to these suggested revisions by the Department of Justice?

Mr. RULE. The revisions that we have recommended last year and continue to support would clarify the antitrust laws over a broad range—in fact, all industries. I think they would provide greater certainty to all businesses, including insurance, if they were subject to the antitrust laws, would alleviate some distortions that are created by the current system of remedies and, overall, would have a beneficial impact.

So the benefits or the effect on the insurance industry would be the same as all other industries if the insurance industry no longer had an antitrust exemption. But in the presence of the McCarran-Ferguson Act, with regard to the business of insurance as opposed to any other conduct engaged in by insurance companies, those provisions would not apply because they, in effect, reform the current substantive antitrust laws which could continue no longer to apply to insurance if the McCarran-Ferguson Act remains as it currently is.

Senator HEFLIN. I believe that is all.

Senator METZENBAUM. Thank you, Senator Heflin.

Senator Humphrey.

Senator HUMPHREY. Mr. Rule, has the Justice Department in recent years testified in favor of repeal of the antitrust exemption or is this something new?

Mr. RULE. This is a fairly traditional position that we have taken. In 1977, we prepared a report that recommended a repeal, and also recommended some Federal regulation that we no longer support.

In 1979, the Commission that was headed by John Shenefield recommended such a repeal and, to my knowledge, the Department has never recommended against repeal of the antitrust exemption for insurance.

Senator **Humphrey**. Thank you.

Mr. Oliver, I recognize the FTC is barred by law from even investigating unfair trade practices in this case. Nonetheless, you are speaking out as a member of the FTC. Have other members spoken out likewise in any forum in favor of repeal of all or part of the law?

Mr. **Oliver**. Senator, I do not know the answer to that. I think the answer is no. A majority of the Commission, of my colleagues, do join me in calling for repeal of at least the antitrust exemption of McCarran-Ferguson. Whether they have made their own separate public statements, I simply do not know, but I think the answer is no.

Senator **Humphrey**. Well, I am curious if this is new. Is this a new position, quasi-official position, unofficial position of the FTC? Is this something new for members to speak out in this fashion—I mean in calling for repeal?

Mr. **Oliver**. I do not know the answer to that, Senator.

Senator **Humphrey**. I am just wondering where members have been, why we have not heard this before.

Mr. **Oliver**. I cannot tell you the answer to that. I have been talking about McCarran-Ferguson since shortly after I got to the Commission in April of last year because I think it is good for consumers, so I have been talking about it since then.

Senator **Humphrey**. Mr. Rule, can you cite any specific examples of abuses that would be curbed if the antitrust exemption were repealed?

Mr. **Rule**. I have no specific examples and, as I have said, the property-casualty crisis, I do not think is due to this. But it does seem to me that where you have an exemption and where companies do not have to be concerned about collusion and cooperative behavior that does not benefit consumers but harms them, it is likely that there probably have been some incidents that have harmed consumers in the past 40 years.

Senator **Humphrey**. Mr. Oliver, can you provide any specific cases?

Mr. **Oliver**. Yes, Senator. In my prepared statement, I mention some cases that the FTC has investigated because claims were brought to our attention and then in the course of the investigation the FTC had to drop out because they turned out to be involving the business of insurance.

We had a case involving a conspiracy to deny compensation for lost future earnings which the FTC in the end thought it could not investigate. We do have several of those and there are more in my prepared statement. I would be happy to submit to you cases we have had.

Senator **Metzenbaum**. Mr. Oliver, would you be good enough to make that information available to the committee with respect to those investigations?

Mr. **Oliver**. Yes, Mr. Chairman, I will.

Senator **Metzenbaum**. Thank you.

Senator **Humphrey**. Can you give us, then, any specific hypothetical examples of how repeal would benefit consumers in the future, Mr. Oliver?

Mr. **Oliver**. Well, if insurance companies were getting together to deny coverage to a particular class of claimants, it seems to me that that would be the kind of activity the FTC or the Justice Department could investigate and stop.

That would be essentially restricting output of the product by the industry, and it is exactly that kind of restriction of output that the antitrust laws are designed to prevent when they are done in a collusive manner.

Senator **Humphrey**. Mr. Rule?

Mr. **Rule**. I suppose there are instances where even though, for example, in property-casualty you have a lot of competitors, you could have in some States, for example, a system where entry is restricted into a particular line of business where there is a prior approval situation and where the insurers are relatively few in number and they get together and they fix price.

No one else is allowed in, and they stick by that price because they recognize that it is in their collective interest to stick by that higher price rather than compete for a lower price that would still allow them to stay in business.

But as I say, I can only give you a hypothetical. I have no specific examples in mind.

Senator **Humphrey**. Well, implicit in the opinion of each of you is the suggestion that State regulatory processes are not working. Why are they not working, if you suggest they are not? Mr. Rule?

Mr. **Rule**. It is not so much that I would contend the State regulatory processes are not working. Indeed, quite to the contrary, I would applaud State regulation of insurance as a good example of the laboratory of federalism at work, and that is why I do not think it should be tampered with.

But I guess what I am saying is that insurance does not have the sort of characteristics, or does not have any characteristics of which I am aware that suggest that it should not be fully subject to competition.

Given that competition is the general policy of this country—and I think it is an important policy, one of the most fundamental that this Nation has—it seems to me unless a very, very strong case can be made by an industry that an exemption is in the public interest, we should not either enact such exemptions nor should we allow their continuation if for some reason they have been enacted in the past.

So the answer essentially is that it is not a question of regulatory failure. It is a notion that competition always is superior to regulation and that States are moving towards more competition, but the one thing that is left in terms of ensuring that there is more competition is getting the antitrust exemption out of the way even though it may not be having that negative an effect in some of the more highlighted areas like property-casualty insurance.

Senator **Humphrey**. Thank you.

Senator **Metzenbaum**. I would just like to say to my colleague from New Hampshire that I happened to be in the legislature when this proposal to regulate at the State level was there and I was so amazed that the insurance industry was coming forward to ask for regulation of its own industry.

But the facts are that in Ohio, and I would guess the same is true in many other States, an insurance company makes a filing. The superintendent of insurance or the commissioner does not evaluate whether that is the right rate or the wrong rate. He conducts no hearing.

It is a filing; it is set by a bureau in some instances, and that is all the regulation that occurs. So although I am not here advocating Federal regulation impliedly, implicitly, indirectly or in any other way, I think it is only fair to say that competitive forces are not working out there in the field and the State regulatory processes are not giving the individual States—some are better than others—the kind of protection that consumers are entitled to.

Senator Grassley.

Senator **GRASSLEY**. Mr. Chairman, I have no questions at this time.

Senator **METZENBAUM**. Thank you.

Gentlemen, thank you very much for your testimony. I might say to you, Mr. Oliver, that the FTC has spoken out on this subject before, at least through its Chairman. I know when Mr. Pertschuk was Chairman, he came out for repeal of the McCarran-Ferguson Act, and I think some of your other predecessors have as well.

Thank you very much. We look forward to working with you.

Our next panel is Mr. James Shannon, attorney general for the State of Massachusetts; Mr. Charles G. Brown, attorney general for the State of West Virginia; and Mr. Jeffrey Teitz, state representative of Rhode Island, speaking on behalf of the National Conference of State Legislators.

I think you gentlemen have all heard me speak to the matter of the 5-minute rule and I hope you will conform with that.

Mr. Shannon, we will be glad to hear from you, sir.

STATEMENT OF A PANEL CONSISTING OF JAMES M. SHANNON, ATTORNEY GENERAL, COMMONWEALTH OF MASSACHUSETTS, ON BEHALF OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL; CHARLES G. BROWN, ATTORNEY GENERAL, STATE OF WEST VIRGINIA; AND JEFFREY J. TEITZ, STATE REPRESENTATIVE OF RHODE ISLAND, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATORS

Mr. **SHANNON**. Thank you, Senator. Good morning. Thank you, Mr. chairman and members of the subcommittee. I appreciate this opportunity to testify in support of repealing the insurance industry's special exemption from our Nation's antitrust laws.

It is a privilege to appear before you in my capacity both as attorney general of the Commonwealth of Massachusetts and on behalf of the National Association of Attorneys General. In this dual capacity, I support the elimination of the antitrust exemption contained in Section 2(b) of the McCarran-Ferguson Act.

I have submitted a written statement and I ask that it be included in the record.

Senator **METZENBAUM**. Without objection, it will be included.

Mr. **SHANNON**. Thank you, Mr. Chairman.

Mr. Chairman, for the second time in this past decade, in Massachusetts, in West Virginia, as General Brown will testify, and in every State in the Union, our citizens and businesses have been subjected to callous and irresponsible conduct at the hands of the insurance industry.

We have experienced cancellations, non-renewals, and walk-outs in a myriad of property-casualty lines, including day care, municipal liability, marine fisheries, and medical malpractice.

In Massachusetts, premium increases for day care facilities rose by as much as 1,000 percent, despite virtually no claims. In Massachusetts, one out of four of our businesses had its commercial insurance canceled or not renewed.

In my State, median rate increases in each line of liability insurance ranged from 25 percent to over 300 percent. In 1985, from Cape Cod to Gloucester, our marine fisheries were left without liability coverage.

Our cities and towns had to turn to self-insurance or go bare because the industry canceled coverage or made coverage prohibitively expensive. The most startling part of this story is that this irresponsible conduct takes place in an industry with assets the size of our national budget and with unparalleled exemption from our Nation's antitrust laws.

On top of this, there is very little effective State regulatory oversight. Except for a few States with comprehensive State insurance schemes such as Massachusetts and New York, there is no one minding the store, and even in States like Massachusetts which have extensive regulation of insurance, we are not insulated from capricious industry conduct.

Thus, the industry has the best of both worlds—no Federal antitrust scrutiny and, in most instances, virtually no State regulatory oversight. I am not aware of a single industry, regulated or unregulated, past or present, with such license in the pursuit of private profit-taking.

I cannot believe for an instant that this outcome was the intent of Congress in 1944 when it rushed to pass the McCarran-Ferguson Act. As the legislative history of the Act demonstrates clearly, its primary purpose was to ensure the continuation of State regulation.

The reason antitrust immunity was included was because of an unfounded fear that the application of the antitrust laws would invalidate State regulatory schemes. We know that that argument, which was not even accurate at the time, is just flatly wrong today.

With the development of the commerce clause and State action doctrine, there is no doubt that States have the power to regulate and tax the insurance industry. We do not need this antitrust moratorium that has gone on for over 40 years.

Immunity from our Nation's antitrust laws should produce stability and reasonable rates. The insurance exemption has produced, instead, an arrogant industry that flaunts its collective power at government and citizens alike.

I challenge the industry to demonstrate to this committee that the presence of immunity generates public benefits that could not be achieved in a more competitive way. I challenge the industry to prove to this committee that it needs this immunity in order to exchange information or engage in joint ventures.

In short, I challenge the industry to prove that American consumers and businesses need this immunity more than the industry does. The only beneficiary of the insurance industry's antitrust immunity is the industry itself.

I urge the Congress to act to repeal this special treatment for the insurance industry. It is long past time to subject the industry to the same rules that the rest of American business is required to observe.

Thank you, Mr. Chairman.

[Statement follows:]

STATEMENT

of

JAMES M. SHANNON

ATTORNEY GENERAL

COMMONWEALTH OF MASSACHUSETTS

on behalf of the

NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

before the

SENATE ANTITRUST, MONOPOLY, and

BUSINESS RIGHTS SUBCOMMITTEE

on S. 80

A BILL TO REPEAL THE McCARRAN-FERGUSON ACT,

AND FOR OTHER PURPOSES

FEBRUARY 18, 1987

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STATEMENT OF JAMES M. SHANNON
ATTORNEY GENERAL OF THE COMMONWEALTH MASSACHUSETTS ON BEHALF OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

INTRODUCTION

Good morning. Thank you Mr. Chairman and members of the subcommittee. I appreciate this opportunity to testify in support of repealing the insurance industry's special exemption from our nation's antitrust laws. It is a privilege to appear before you in my capacity both as Attorney General of the Commonwealth of Massachusetts and on behalf of the National Association of Attorneys General (NAAG)1/

In this dual capacity I support eliminating the antitrust exemption contained in Section 2(b) of the McCarran-Ferguson Act. (15 U.S.C. §1012(b)). No other industry enjoys such an express grant of unsupervised and broad immunity from the antitrust laws. I believe it is crucial to repeal this immunity because it does not serve the public interest. Such repeal need not, and should not, however, interfere with the historic right of the states to license, regulate, and tax the business of insurance.2/

1/ NAAG is a bipartisan association made up of the attorneys general of all 50 states and 5 U.S. territories.

2/ At its June 1986 meeting in Seattle, Washington, the members of NAAG voted unanimously to urge the "Congress of the United States to repeal the special immunity from the antitrust laws granted to the insurance industry and to subject insurance companies to the rules of the competitive marketplace applicable to other firms...." The full text of the NAAG resolution is attached hereto.

My testimony this morning, will make the following points:

First, the special immunity should be repealed because it fosters collective conduct that harms consumer welfare;

Second, with the development of state action and commerce clause legal doctrines, the original justifications for the exemption no longer exist;

Third, states will --as they should-- be able to continue to regulate the insurance industry: the application of the nation's antitrust laws to the industry is fully compatible with continued state regulation and taxation of this industry.

Finally, repealing immunity will not eliminate joint activities that are authorized by the state or that encourage efficiency and competition.

I.
IMMUNITY SHOULD BE REPEALED

The volatility in the insurance industry that we have witnessed in the past year has prompted serious questions about the relationship between industry conduct and the immunity it enjoys from the antitrust laws. Collective responses by the insurance industry to economic problems have exacerbated cancellations, withdrawals, and skyrocketing rates. Even though this apparent crisis seems to have subsided recently, I urge that the scrutiny continue and that we act now to prevent history from repeating itself.

Careful scrutiny makes clear that the insurance industry's antitrust exemption is not promoting the public interest. Certainly, one of the foremost reasons for granting antitrust immunity to any industry in the first place is to produce public benefits -- stability in the supply of a product at reasonable and affordable rates. The immunity afforded the insurance industry, however, has resulted in neither stability in the availability of insurance nor affordable rates.

A. The Exemption Has Not Provided Stability

If the goal of antitrust immunity for the insurance industry is stability in the availability of insurance, that goal plainly has not been achieved. For example:

--Across the country, entire lines of insurance have been cancelled or made subject to nonrenewal. In Massachusetts, in 1986, the only two carriers providing dental liability insurance stopped writing new policies. This action was taken by both companies after state regulators rejected rate increase demands of almost 100 percent;

--Within the past two years many states have experienced a total walkout by carriers providing coverage to day care facilities;

--Cities and towns across the country, including in Massachusetts, have had to "go bare"[3/] or turn to self-insurance

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[3/] "Going bare" means that the municipality has no liability coverage.

in order to obtain liability coverage because carriers stopped providing municipal liability insurance;

--Massachusetts hazardous waste facilities have found liability insurance to be unavailable;

--Construction contractors, human service providers, recreation and sports facilities all have experienced serious problems in securing general liability insurance coverage;[4]

--In the past two years, one in four commercial liability insurance policies in Massachusetts has been cancelled or not-renewed;[5]

If the goal of antitrust immunity is stable and affordable rates, that goal has not been realized:

--Since 1984, in Massachusetts, median rate increases in each line of liability insurance ranged from 25 percent to 329 percent;[6]

--In 1985 a survey by the Greater Boston Chamber of Commerce reported that 17 percent of Boston area businesses experienced increased premiums of 500 percent or more;[7]

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[4] Survey by Abt Associates, Inc. of Cambridge, MA, commisssioned by the Massachusetts Governor's Task Force on Liability Issues. See, Report of the Task Force, December 1986, at p. 15.

[5] Id. at pp. 12-13.

[6] Id. at 13.

--The Government Accounting Office reported that for 1980 - 1986 medical malpractice rates across the country ranged from 41 percent to 547 percent;[8]

In general, these higher rates have purchased less coverage due to the industry's use of restrictive and exclusionary policy forms and endorsements, increased retentions (deductibles) and lower policy coverage limits.

B. The Exemption Fosters Irresponsible Collective Conduct

The conduct of insurance industry trade associations reflects a cavalier attitude toward the public welfare that is absent in industries subject to the antitrust laws. A recent striking example of this type of conduct was the industry's compaign to secure authorization for the Insurance Services Organization's (ISO) commercial general liability (CGL) claims-made form.[9] In my state of Massachusetts, industry representatives testified before our Insurance Commission that any state that failed to approve this anti-consumer form risked being boycotted by the world-wide reinsurance markets. We also were told that one of the more troublesome aspects of the ISO claims-made form, the so-called "retro date",10/ was introduced at the insistence of reinsurers in the London market. One must wonder whether it is appropriate for the industry rating bureau, ISO, to broker an industry-wide agreement to insure only under a form that has but one purpose: to limit the liability exposure of insurance companies at the expense of consumers.

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[7] Id. at 14.

[8] GAO Report on Medical Malpractice, December 1986, p. 4.

[9] A claims-made policy is one under which the insurer has responsibility only for those claims filed during the policy period. Under the ISO claims-made form, even claims that are filed during the policy period will not be covered if they involve claims which occurred prior to the policy's "retro date."

Another example is the pattern of collective conduct that occurs when a particular line of insurance has become unavailable or unaffordable in a particular state: virtually all of the companies writing the policy involved take similar actions. We are not seeing "maverick" insurers breaking ranks and offering coverage to fill-in the gaps. Thus, when virtually all the companies offering a particular property/casualty line "pull out" or refuse to write any new policies until their rate requests are met, the effect on the market is substantial.

10/ A "retro date" is the date designated under certain claims-made policies (including the ISO CGL form) after which an occurrence must take place if it is to be covered; occurrences prior to the retro date are not covered even if the claim is filed during the policy period.

C. The Exemption Fosters Harmful Unilateral Conduct

In addition to collective conduct, certain unilateral conduct is fostered by the antitrust exemption that is detrimental to consumers. For example, a pervasive practice in the insurance industry involves the marketing of tying arrangements. In insurance jargon, these typically are referred to as "packaging arrangments." Basically, property/casualty companies will require that agents sell certain amounts of each line of insurance in order to avoid a concentration in unprofitable lines. Agents in turn require that a customer purchase a package policy which will tie together the profitable and unprofitable lines. For instance, some frequently "tied" packages include: homeowners and auto; liquor liability and other commercial property/casualty; and general commercial liability and worker's compensation. Generally, there is no economic benefit to the customer who is forced to purchase two types of insurance rather than the desired single policy. Under current law, however, tying arrangments such as these generally are considered the "business of insurance" and therefore exempt from antitrust challenge. Dexter v. Equitable Life Assur. Society of U.S., 527 F.2d 233 (2nd Cir. 1975); Feinstein v. Nettleship Co. of

Los Angeles, 714 F.2d 928 (9th Cir. 1983).[11]

This hardly adds up to a record of activity by an industry, exempt from the antitrust laws, that benefits the public. The existence of the immunity is not providing the public with a stable industry selling its service at affordable rates. The fundamental public welfare reasons for continuing antitrust immunity are lacking. It is clear that the only beneficiary of the insurance industry's antitrust immunity is the industry itself.

D. The Exemption and Antitrust Enforcement

Even under present law, of course, certain of the industry's collective conduct may be subject to antitrust attack under the exception to the antitrust exemption for acts or agreements to boycott, coerce or intimidate, (15 U.S.C. 1013(b)). It also is possible to challenge the industry for conduct beyond the scope of effective state regulation. In this latter regard, however, we face a proliferation of lower court decisions generally interpreting the exemption expansively by requiring only a minimal level of state regulation.[12/] Moreover, the Supreme Court, in 1958, rejected an argument by the FTC that there was a distinction between the mere existence of state legislation and the regulation by the state required to satisfy the McCarran-Ferguson exemption.[13/]

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[11] In the absense of immunity, the continued legality of these arrangements will depend on a number of factors such as whether there are two distinct products involved and whether the insurance company in question has sufficient market power in one product to force the purchase of another. See Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 104 S. Ct. 1551 (1984). Although it may be argued that a successful challenge to an insurance tying arrangement may now be possible under an expansive view of the coercion exception to the McCarran-Ferguson Act exemption, my office is aware of no successful challenge on this particular issue to date.

In spite of these hurdles, a small number of states -- Massachusetts and West Virginia among them -- are investigating certain types of industry conduct that may be subject to antitrust challenge. For example, some state attorneys general currently are looking into the possibility of an agreement among certain reinsurance providers to restrain deliberately the availability of reinsurance. Since I am constrained from discussing publicly on-going investigations, I cannot comment

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[12/] See, e.g. Ohio AFL-CIO v. Insurance Rating Bd., 451 F.2d 1178 (6th Cir. 1971); California League of Independent Ins. Producers v. Aetna Cas. & Sur. Co., 175 F.Supp. 857 (N.D. Cal. 1959). There have been very few Supreme Court decisions which bear directly on interpreting the exemption itself. Although these cases generally construed the scope of the exemption narrowly, they have not focused on the extent or quality of state regulation necessary to trigger the immunity. There were only three Supreme Court cases construing the Act between 1945 and 1977: SEC v. National Sec., Inc., 393 U.S. 453 (1969); SEC v. Variable Annuity Life, Inc., 359 U.S. 65 (1969) and FTC v. National Casualty, 357 U.S. 560 (1958). Since 1978 there have been three more decisions: Union Labor Life Insurance Co. v. Pireno, 102 S. Ct. 3002 (1982); Group Life Health Insurance Co. v. Royal Drug Co., 440 U.S. 205 (1979) and St. Paul Fire and Marine Insurance Co. v. Barry, 438 U.S. 531 (1978).

[13/] See, FTC v. National Casualty, supra.

further on the specifics of this investigation. I want to make it clear, however, that the antitrust resources of any single state would be strained severely in any major challenge to the insurance industry. This is due in large part not only to the virtually unlimited resources available to national insurers to litigate, but also to the serious legal hurdles created by the industry's broad immunity from the antitrust laws. Many states do not even have antitrust divisions in the offices of their attorneys general, and those that do are relatively small. I know that if the Massachusetts Antitrust Division were to initiate a major antitrust challenge in this area, it would require almost all the Division's resources.

I believe that repealing the industry's antitrust immunity would produce the following benefits:

First, such repeal would have a very pronounced taming effect on the collective conduct of the industry. The industry would be highly motivated to police itself to avoid antitrust exposure. Hopefully, with the exposure to treble damage antitrust liability, the industry would think twice before threatening to withdraw en masse from certain lines or geographic areas.

Second, the antitrust resources of the federal government would be available to prosecute alleged illegal conduct. The threat of criminal as well as civil prosecution by the Justice Department is an added incentive in most industries to monitor closely compliance with the antitrust laws.

Third, the repeal of immunity would subject the industry to the same legal standards applied to every other industry. This clarity would assist state prosecutors by removing a major legal hurdle now faced when we try to reign in anticompetitive industry conduct. At present, industry counsel do not hesitate to assert that McCarran-Ferguson immunity blocks state attorneys general from enforcing either federal or state antitrust laws against the industry.

II.

ORIGINAL JUSTIFICATIONS FOR THE EXEMPTION NO LONGER EXIST

The legislative history of the McCarran-Ferguson Act shows that it was passed primarily to ensure that states would be able to continue to license, tax and regulate the insurance industry.[14/] Congress was concerned that continued application of the antitrust laws could be used to invalidate state laws regulating insurance. This concern which followed

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[14/] *See*, generally, Cong. Rec. Vol. 91, part 1, 79th Cong., 1st Sess., pp. 478-488.

in the aftermath of the Supreme Court decision in the South-Eastern Underwriters[15/] case, -- was perhaps understandable at the time, but was nonetheless, unfounded. This view was expressed at the time by President Franklin Roosevelt in a letter to one of the senators who was advocating antitrust immunity:

> The responsibility for the regulation of the business of insurance has been left with the States; and I can assure you that this administration is not sponsoring Federal legislation to regulate insurance or to interfere with the continued regulation and taxation by the States of the business of insurance. But there is no conflict between the application of the antitrust laws and effective State regulation of insurance companies, and there is no valid reason for giving any special exemption from the antitrust laws to the business of insurance. The antitrust laws prohibit private rate fixing arrangements between insurance companies and acts of boycott, coercion or intimidation. The antitrust laws do not conflict with affirmative regulation of insurance by the States such as agreed insurance rates if they are affirmatively approved by State officials.

Cong. Rec. Vol. 91, Part 1, 79th Cong., 1st Sess. p. 482 (1945), (emphasis added).

[15/] In United States v. South-Eastern Underwriters Association (SEUA), 322 U.S. 533, the Justice Department charged an association of 200 fire insurance companies with conspiratorial fixing of rates and agents commissions. The district court dismissed the indictment on the basis of previous Supreme Court decisions holding that the business of insurance was not in interstate commerce. Paul v. Virginia, 75 U.S. (8 Wall), 168 (1869). In SEUA, the Supreme Court reversed the lower court and held that insurance was indeed in interstate commerce and subject to federal antitrust laws.

Events subsequent to the 1944 passage of the McCarran-Ferguson Act show the wisdom of President Roosevelt's words. Developments in the law concerning the commerce clause and state action have now rendered the original reasons obsolete.

A. The Commerce Clause

It is now clear that the commerce clause is not an obstacle to state taxation and regulation of insurance. Just one year after the Act was passed, the Supreme Court held that California's insurance regulations designed to weigh more heavily on out of state insurers did not violate the commerce clause, Robertson v. California, 328 U.S. 440 (1946). Subsequent cases established with even greater certainty that the commerce clause does not interfere with a state's ability to tax or regulate any line of commerce, so long as the state's action does not impede the flow of interstate goods Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978), or unduly discriminate against interstate commerce.[16/]

B. The State Action Doctrine

The state action doctrine makes clear that the insurance activities subject to state regulation will remain outside the scope of antitrust immunity. When the McCarran-Ferguson Act

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[16/] See, e.g., Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977); Dean Milk Co., v. City of Madison, 340 U.S. 349 (1951).

was passed, the state action doctrine, established by Parker v. Brown, 317 U.S. 341 (1943), was barely one year old. Since the passage of the Act, the parameters of the doctrine have been expanded greatly and its application to state insurance laws and regulatory schemes cannot now be in doubt.

Under the state action doctrine, state authorization and supervision of private anticompetitve conduct immunizes such conduct from antitrust exposure.[17/] Moreover, the recent trend in state action cases has been one of increasing judicial deference toward state regulatory policies.[18/] As long as the state has determined to displace competition with a regulatory regime, the Supreme Court has held that a private defendant "need not 'point to a specific, detailed legislative authorization' for its challenged" conduct.[19/]

Thus, the primary reasons originally advanced in support of McCarran-Ferguson were false alarms. The ability of the states to regulate and tax the insurance industry is in no way dependent on the industry's exemption from the federal antitrust laws.

17/ See, e.g., Southern Motor Carriers Rate Conference (SMCRC) v. U.S., 471 U.S. 48 (1985); California Retail Liquor Dealers Association v. Midcal Aluminum, Inc., 445 U.S. 97 (1980).

18/ See Merrick B. Garland, Antitrust and State Action: Efficiency and the Political Process, 96 Yale L.J. 486 (1987).

19/ SMCRC at 64.

III.
REPEAL OF IMMUNITY WILL NOT INTERFERE WITH STATE REGULATION

Repeal of immunity will not adversely effect the ability of the insurance commissioner in my state or in others to regulate the industry. At present, the Massachusetts commissioner's authority is based on a comprehensive state statutory scheme permitting regulation of the industry, including regulation of rates for certain types of insurance. For instance, the scheme permits the collective recommendation of automobile insurance rates by the Massachusetts Auto Rating Bureau and under the scheme, the final rate is set by the Commissioner. For those areas, such as homeowners' insurance, that are not presently heavily regulated, the commissioner could increase or decrease regulation consistent with the authority he presently has.

Repeal of federal antitrust immunity will not restrict him. He is and will continue to be authorized and bound by the state scheme. Without immunity, the state action doctrine would apply to collective conduct by the insurance industry just as it does to public utilities, motor carriers, health care providers, state banks, and any other industry subject to state regulation in Massachusetts.

This is true for other states as well. Regardless of the extent of the state's regulation of insurance, the state action doctrine will apply. States will be free to expand or contract their regulation of insurance.

IV.

REPEAL OF IMMUNITY WILL NOT ELIMINATE JOINT INDUSTRY ACTIVITIES THAT ARE AUTHORIZED BY THE STATE OR THAT ENCOURAGE EFFICIENCY

Opponents of repealing antitrust immunity argue that such action would make it impossible for the insurance industry to engage in many of the joint activities claimed to be necessary to its continued viability. It is clear, however, that ratemaking, information exchange, standard forms, and joint underwriting activities that either are subject to state regulation or are pro-competitive and encourage efficiency can continue even in the absence of antitrust immunity.

A. Rates and Ratemaking

If the McCarran-Ferguson Act exemption is repealed, insurance industry ratemaking processes would be subject to Section 1 of the Sherman Act, in the absence of a state regulatory scheme that authorizes collective ratemaking. As discussed above in Section II, however, the state action exemption has been interpreted very broadly by the Supreme Court in this area, and will be applicable to most state ratemaking settings.[20/] Basically, as long as the regulation

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[20/] Since mid-1982, the Court has upheld against antitrust attack all five state or local regulatory schemes that have come before it. See, Fisher v. City of Berkeley, 106 S. Ct. 1045 (1986); Southern Motor Carriers Rate Conf. v. United States, 471 U.S. 48 (1985); Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1985); Hoover v. Ronwin, 466 U.S. 558 (1984); Rice v. Norman Williams Co., 458 U.S. 654 (1982).

represents a clearly articulated state policy to displace competition with regulation, and, as long as the state supervises any private anticompetitive conduct, action pursuant to the regulation will be free from antitrust review. Southern Motor Carriers Rate Conf., supra.

As a result, agreements in the industry to set rates collectively would be subject to antitrust scrutiny only where there is no articulated state policy consistent with the state action doctrine.

B. Pooling of Statistical Data

It is not a violation of the antitrust laws for industries to collect and share information unless such arrangements are used for anticompetitive purposes. In the insurance industry, rating bureaus collect and disseminate loss information, risk ratios and other types of statistical information. The repeal of antitrust immunity should not interfere with such data collection and dissemination functions as long as rating bureaus do not "recommend rates".21/

In the life/health insurance area, the repeal of the McCarran-Ferguson Act will have substantially no effect on the information exchange necessary for that industry. Life

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21/ The recommendation of rates would be permissible, of course, if done pursuant to a state regulatory scheme.

expectancy tables and health data are readily available for industry use.[22] For the most part, life/health rates are not set collectively but, instead, are determined by individual companies.

The question is somewhat more complex for the property/casualty underwriters who have engaged in cooperative assembling of loss statistics. It is not unusual for the industry's "rating bureau," ISO, to collect the loss data and then to "recommend" rates aimed at achieving certain overall profit margins. While the exchange of loss information through a rating bureau would not in itself be illegal, (Maple Flooring Manufacturing Association v. United States, 268 U.S. 563 (1928)), the "recommendation" of rates by ISO would pose antitrust concerns, unless such conduct was authorized by the state. There is no reason, however, why an individual property/casualty company cannot set its own rates unilaterally, based on industry loss data.

If insurers wished to avoid antitrust scrutiny, historical, or even current, price data could be exchanged in a form that is aggregated and not specifically identified for each insurer. Furthermore, where it is necessary to pool price data or loss experiences, insurers should use independent consulting organizations, rather than industry controlled rating bureaus, such as the ISO, in order to steer clear of the antitrust laws.[23]

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[22] In 1979, the National Commission for the Review of Antitrust Laws and Procedures concluded that there was no justification for continued immunity in this area. 1979 Report to the President and the Attorney General, at p. 65.

C. Standard Policy Forms and Risk Classifications

Generally, standard contract forms do not violate the antitrust laws, as long as their adoption by individual business is voluntary and their use does not facilitate unauthorized pricefixing or output restrictions among competitors. In the same vein, collecting data to facilitate standard risk classifications, a legitmate data collection function, would not violate antitrust laws, as long as the classification system is adopted voluntarily and not used for anticompetitive purposes. Moreover, the state action exemption will apply in this area in states where the current regulatory scheme includes the approval of policy forms by the state insurance commission.

D. Joint Underwriting and Joint Insurance

The insurance industry employs a variety of inter-company risk-sharing arrangements commonly referred to as "insurance pools." These pools typically provide insurance or reinsurance coverage for specific risks not handled by individual insurers. Insurance pools also provide a means by which special classes of insureds can receive reduced rates which they would be unable to receive from individual companies. Property/casualty insurers traditionally have shared large risks through pooling and reinsurance.

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[23] This was one of the recommendations in the 1977 Report of the U.S. Department of Justice to the Task Group on Antitrust Immunities, pp. 177-78.

If immunity is repealed, the antitrust exposure of private voluntary pools will be tested under the laws applicable to joint ventures. A joint venture is a joint business undertaking by two or more parties who share both the risks and profits of the business. Joint ventures have become more commonplace among U.S. businesss and often are utilized by businesses that do not receive any special antitrust immunity. Such ventures are by no means inherently illegal under federal antitrust laws. The conduct will be subject to antitrust exposure, however, if the effect of the venture is to foreclose actual or potential competition between its participants or other potential or existing competitors in the market. _Citizens Publishing Co. v. U.S._, 394 U.S. 131 (1969); _U.S. v. Penn-Olin Chemical Co._, 378 U.S. 158 (1964).

For companies contemplating joint ventures, exposure can be avoided by using the Department of Justice Business Review procedure. Under this procedure, companies anticipating business arrangements with a potential antitrust problem may request a statement of enforcement intentions from the DOJ on the prospective conduct. The DOJ Business Review procedure will be a good vehicle for resolving concerns involving the continuation of joint insurance company activities after the repeal of antitrust immunity.

Increasingly, state administered insurance pools, known as Joint Underwriting Associations (JUA), are being established. In Massachusetts, JUAs currently are operating to provide coverages, such as medical malpractice and liquor liability. Where the pools are established and run by the states, the state action exemption will apply to an antitrust challenge.

CONCLUSION

Attorneys general across the nation have added their voices to those calling for the repeal of the insurance industry's antitrust immunity. This is not a new call. Almost 10 years ago, the 1977 Report of the Antitrust Division of the Department of Justice concluded that the insurance industry:

> should be able to conduct its business without any special exemption from the federal antitrust laws. Antitrust precedent indicates that insurance companies could pool their loss experience through a statistical bureau consistent with federal antitrust standards. Moreover, the federal antitrust laws would not prohibit any necessary trending of future losses on a composite basis by advisory organizations that were independent of the companies they were serving. Likewise, the antitrust laws would not prohibit those voluntary risk-sharing agrangements, such as insurance pools and reinsurance agreements, that were either necessary to the conduct of business or served some other legitimate business purpose without substantially lessening competition.

1977 Report to the Task Group, supra, at vii-viii.

Two years later, this refrain was echoed in even stronger terms by the National Commission for the Review of Antitrust Laws and Procedures which recommended that, "The current broad immunity for the business of insurance granted by the McCarran-Ferguson Act should be repealed."[24/]

The National Association of Attorneys General believes that the industry's broad immunity from the antitrust laws has not provided the public with the benefits normally expected from an industry entrusted with such a privilege and, therefore, it should be repealed.

[24/] Report to the President and the Attorney General of the National Commission for the Review of Antitrust Laws and Procedures, January 22, 1979 at p. 64. The Commission went on to recommend also that certain narrowly drawn federal legislation be adopted to affirm the lawfulness of a limited number of essential collective activities under the antitrust laws.

Senator **Metzenbaum**. Mr. Shannon, I understand you are speaking on behalf of the National Association of Attorneys General.

Mr. **Shannon**. I am sir, and General Brown is as well.

Senator **Metzenbaum**. Pardon?

Mr. **Shannon**. General Brown is as well.

Senator **Metzenbaum**. And is it my understanding that the action taken on this subject was voted unanimously to support repeal of the McCarran-Ferguson Act?

Mr. **Shannon**. Yes, it was, Senator.

Senator **Metzenbaum**. And that was in June of 1986?

Mr. **Shannon**. That is right.

Senator **Metzenbaum**. That included Delaware, did it not?

Mr. **Shannon**. Yes, it did.

Senator **Metzenbaum**. Does the Senator from Delaware have an opening statement?

The **Chairman**. Yes, I do. We are a part of the Union. [Laughter.]

I might add the first State.

Senator **Metzenbaum**. Mr. Brown, we are happy to welcome you here.

Mr. **Brown**. Thank you, Chairman Metzenbaum, and good morning. Thank you, Mr. chairman and members of the committee. I appreciate the opportunity to offer my testimony before the subcommittee in support of the provisions of Senate bill 80, which would eliminate the antitrust exemption presently enjoyed by the insurance industry under the McCarran-Ferguson Act.

Today, it is my great pleasure to speak in a dual capacity both as West Virginia's attorney general and as vice chairman of the antitrust committee of the National Association of Attorneys General, and to join my colleague, General Shannon of Massachusetts.

My organization supported ending the antitrust exemption for insurance, and this organization represents the chief law enforcement officers in all of our 50 States.

I believe the events of last April in my State of West Virginia present an extraordinary, almost unbelievable demonstration of the power of the insurance industry to use their existing antitrust immunity to attempt brazenly, and to succeed, in the wholesale repeal of reform legislation distasteful to the industry as insurance reform rather than tort reform.

The power displayed was the combined, coordinated, simultaneous, mass cancellation of medical malpractice coverage in our State. That demonstration of power exemplifies to my mind and to most of the citizens of West Virginia why the McCarran-Ferguson antitrust exemption should be scrapped.

The experience of the Nation, and certainly the experience of West——

Senator **Metzenbaum**. Mr. Brown, you are going so fast. Do I understand that the entire insurance industry as a group canceled all malpractice policies? Is that what you are saying?

Mr. **Brown**. That is right, Mr. Chairman, 7,600 policies simultaneously canceled and they pulled out. I filed an antitrust case and was able to get a preliminary injunction 48 hours before the cancellation would have started.

The testimony we had before the court was that, for example, the ambulance service would have shut down in some counties, no ambulance service at all because of no insurance; no kidney dialysis unit in southern West Virginia.

We had testimony that really people would have died because they could not get kidney dialysis treatment, had that eventuality happened, and we came within 48 hours of it starting to happen.

Suddenly, those who need insurance and desire to buy insurance cannot seem to find anyone willing to sell them insurance. Here is a situation where everyone seems to be in the same fix. It does not matter whether you are John Q. Public, a doctor or a Fortune 500 corporation.

Those companies that sold you insurance last year are not much interested in selling you insurance this year. If they have not canceled your policy or sent you a non-renewal notice, you can bet your bottom dollar that they have raised the price threefold, fourfold, or more.

I ask you where else in the American economy do prices rise for goods and services by hundreds of percent, or where in this economy can the supply of goods and services be cut off like water from a tap? In this day and age, only insurance.

As a former antitrust lawyer, I firmly believe that such extraordinary, excessive pricing and such absolute control of supply can only occur in a marketplace environment where anti-competitive practices have long been the rule, not the exception.

If our citizens, our doctors, our hospitals, our local government units, our businesses and our industries are to have access to affordable and available insurance coverage, then I believe we must at all levels of government attempt to restore that equity, that balance, that give-and-take which has been lost in the relationship between those who need coverage and those who supply coverage.

There are no easy solutions; there never are. I believe that any solution to our present dilemma will certainly be multi-faceted and, no doubt, will involve a variety of remedies at the State and Federal level designed to wean the industry of its cash flow underwriting addiction and place the industry under more meaningful regulatory scrutiny in an environment free from anti-competitive practices. I applaud Senate bill 80 as an important first step.

Let me tell you what happened in my State. Senator Humphrey asked what anti-competitive practices have occurred. The hypothetical of a joint, simultaneous withdrawal indeed happened in West Virginia less than 1 year ago.

In the 1986 session of our legislature, the questions of liability crisis and tort reform were addressed from all viewpoints by our legislature, and indeed some aspects of tort reform and some aspects of insurance reform were passed within the same bill.

Ten days or so after enactment, in a move unprecedented up to that time in the 49 other States, 5 of the largest medical malpractice insurers in our State simultaneously canceled medical malpractice coverage of 7,600 policyholders—doctors, dentists, hospitals, nurses, rural health clinics, and other health professionals.

In what I believe to have been a concerted attempt to force repeal of this particular bill, CNA canceled 5,300 policies, St. Paul canceled 1,400 policies, and Ohio Hospital Insurance Company canceled the policies of more than half the hospitals in our State.

Though these canceled policies represented the vast majority of all medical malpractice coverage in West Virginia, they were only a negligible, indeed minuscule, portion of the companies' national business.

For CNA, it was about seven-tenths of one percent of their national business; St. Paul, two-tenths of one percent. Basically, it was not a major impact on them, Mr. Chairman.

I want to just, if my time is up, address one other point. I do have written comments for you. The Senator had asked about the problem of insurance advertising in the FTC. I have asked my legislature to address the problem of insurance advertising through our consumer protection law which, not surprisingly, exempts insurance.

We see national advertising now by famous people urging senior citizens to buy medi-gap insurance, medical supplement, promising them they cannot be turned down for any reason when pre-existing conditions are not covered.

To me, this is quite deceptive. No one has acted against it from any State or from the Federal Trade Commission. I think again we see the inadequacies of someone able to act against insurance problems.

Thank you very much.

[Statement follows:]

STATEMENT OF CHARLES G. BROWN
ATTORNEY GENERAL OF THE STATE OF WEST VIRGINIA

February 18, 1987

Good Morning. Thank you, Mr. Chairman and committee members, for this opportunity to offer my testimony before the subcommittee in support of the provisions in Senate Bill 80 which would eliminate the antitrust exemption presently enjoyed by the insurance industry under the McCarran-Ferguson Act. Today it is my great pleasure to speak here in a dual capacity as both West Virginia's Attorney General and as vice chairman of the Antitrust Committee of the National Association of Attorneys General.

I believe the events of last April in my state present an extraordinary--almost unbelievable--demonstration of the power of the insurance industry to use their existing antitrust immunity to brazenly attempt and succeed in the wholesale repeal of reform legislation distasteful to the industry as insurance reform rather than tort reform. The power displayed was the combined, coordinated, simultaneous mass cancellation of medical malpractice coverage in our state. That demonstration of power exemplifies to my mind and to most of the citizens of West Virginia why the McCarran-Ferguson antitrust exemption should be scrapped.

The experience of the nation and, certainly, the experience of West Virginia over the past year tells us that whatever equitable balance may previously have existed between those who supply insurance and those who need insurance has been lost. One hallmark of our free market economy is the "give and take" between buyer and seller. Somewhere along the line this has become all "take" and no "give." Can General Motors go out tomorrow and increase the price of a GM car threefold, fourfold or more? Can you imagine GM refusing to sell cars? And, just how long do you suppose General Motors would be in business if they began refusing to sell cars to willing purchasers? These questions may sound like absurdities, however, they become considerably less absurd in the situation where Ford, Chrysler, and the Japanese stop selling their cars along with GM. Or, in the other instance, triple or quadruple their prices in concert with one another. Strangely enough, our hypothetical questions begin to line up uncomfortably close with contemporary reality when we merely substitute the nation's largest insurers into our scenario.

Suddenly, those who need insurance and desire to purchase insurance can't seem to find anyone willing to sell them insurance. Here is a situation where everyone seems to be in the same fix. It doesn't matter whether you're John Q. Public or Fortune 500 Corporation, but those companies that sold you insurance last year aren't much interested in selling you insurance this year. And if they haven't cancelled your policy or sent you a nonrenewal notice you can bet your bottom dollar that they've raised the price threefold, fourfold or more. Well, I ask you, where else in the American economy do prices rise for goods and services by hundreds of percent? Or, where in this economy can the supply of goods and services be cut off like water from a tap?--In this day and age, only insurance. As a veteran antitrust attorney, I firmly believe that such extraordinarily excessive pricing and such absolute control of supply can only occur in a marketplace environment where anticompetitive practices have long been the rule, not the exception.

If our citizens, our doctors, our hospitals, our local governmental units, our business, and our industries are to have access to affordable and available insurance coverage, then I believe that we must at all levels of government attempt to restore that equity, that balance, that "give and take" which has been lost in the relationship between those who need coverage and those who supply coverage. There are no easy solutions. There never are. I believe that any solution to our present dilemma will certainly be multi-faceted and no doubt will involve a variety of remedies at the state and federal level designed to wean the industry of its cash flow underwriting addiction and place the industry under more meaningful regulatory scrutiny in an environment free from anticompetitive practices. I applaud Senate Bill 80 as a most important first step. I think you will understand just how important this bill is to the people of my state after you ponder the history of the liability "crisis" there.

In the 1986 session of our legislature, the questions of liability "crisis" and tort reform were addressed from all viewpoints in the legislative debate. As could be expected, a variety of positions on these issues were lobbied for by their respective constituencies, both pro and con. These issues were among the most significant before our legislature last year and engendered considerable debate. The resulting legislative process led to the enactment of Senate Bill 714 which embodied aspects of both insurance and tort refor. Our governor signed SB 714 into law despite the insurance industry's immediate calls for its veto.

Ten days or so after enactment, in a move unprecedented up to that time in the 49 other states, five of the largest medical malpractice insurers in our state simultaneously cancelled the medical malpractice coverage of well over 6500 policyholders--doctors, dentists, hospitals, nurses, rural health clinics, and other health professionals. In what I believe to have been a concerted attempt to force the repeal of this particular bill, CNA cancelled 5300 policies, St. Paul cancelled 1400 policies, and Ohio Hospital Insurance Company cancelled the policies of more than half of the hospitals in our state. Though these cancelled policies represented the vast majority of all medical malpractice coverage in West Virginia, they were only a negligible and miniscule portion of the companies' national business. Evidence adduced in a hearing before our state insurance commissioner established that CNA's business in West Virginia represented seven-tenths of one percent of its national business. St. Paul's business in West Virginia represented two-tenths of one percent of its national business. Health professionals seeking alternative sources of coverage from other insurers were turned away at the door. Insurance companies were not writing coverage in our state. None. The supply of coverage was cut off.

The actions of these insurance companies were designed to effect two purposes: First, to force the repeal of Senate Bill 714 in our state, and secondly, to present a forceful object lesson to the other 49 state legislatures in this country. The insurance industry was saying "we want tort reform not insurance reform. You give us tort reform or we'll do to you what we did to West Virginia."

In May, our governor called a special session of the state legislature to address the problem. Since these cancellations were not effective until May 31, 1986, the spectre of 7,000 cancelled policies hung over the head of our legislators. We believe that the companies involved, CNA, St. Paul, Ohio Hospital Insurance Company, and others, attempted nothing less than wholesale extortion and blackmail upon the citizens of our state and that citizenry's democratic legislative process. The actions of these companies were an abusive usurpation of the legislative process. This, I assure you was no mere lobbying. Their attitude was "we don't like your law and we are powerful enough to force its repeal." And they succeeded. The insurance reform provisions of our Senate Bill 714 were later eliminated while the tort reform provisions were retained by the special session of the legislature that met last May while the 7000 cancellations were pending. You can imagine the pressure brought to bear upon both our executive and legislative branches by the press of these cancellations with their May 31st deadline.

Seven days after the first notices of cancellation, I filed an antitrust lawsuit in circuit court against CNA, St. Paul, and Ohio Hospital Insurance Company for violations of our state antitrust act by unlawfully engaging in a combination or conspiracy to discontinue the sale or supply of insurance for the purpose of fixing, controlling or maintaining the market rate for insurance. On April 18, 1986, in a hearing for a request for a temporary injunction against those companies to prevent them from cancelling or nonrenewing policies, the circuit court heard evidence from ten health professionals and doctors about the dire consequences that the cancellations would have upon the delivery of health care in our state. These consequences would have been dire indeed. Upon cancellation numerous medical providers would cease operation leaving the medically indigent and medically underserved without any source of health care. Two especially severe circumstances were that the only dialysis unit in Mercer County would close, and the only ambulance service in that county would also have been forced to close. We were not talking about one or two doctors or hospitals. We were talking about the entire health care system in the state of West Virginia. On May 31, 1986, it would have been brought to its knees. Our ongoing investigation revealed that other insurers were absolutely not writing medical malpractice coverage in our state. There was no source of alternative medical malpractice coverage whatsoever.

As part of the case which we presented in circuit court, we established that other states had enacted statutes and regulations which were substantially similar to our Senate Bill 714. Strangely enough, the liability insurance industry including CNA and St. Paul continues to conduct business in those states without loss of profit. No evidence has been brought to date that would in any way whatsoever establish that CNA or St. Paul would lose profits under the requirements of our state Senate Bill 714. It is especially important to keep in mind the miniscule portion that their West Virginia business represented of their entire business activity.

In the course of the antitrust litigation we retained expert economic counsel to study the profitability of the medical malpractice lines of the five defendants in West Virginia for 1985. The report prepared by that expert established that these companies had very handsome profits. In most cases, above 50%, and as extreme as a 297.8% profit for American Casualty for 1985. We believe this data makes nonsense of industry claims that they could not do business under the terms of Senate Bill 714. More likely, they decided that they would not do business in an environment which placed closer scrutiny on excessive premium earnings and profits.

One of the companies in question--St. Paul Fire and Marine--earned 73.6% on its medical malpractice line in our state in 1985 and yet requested a 136% rate hike for oral surgeons in 1986. Our expert reviewed this rate filing and determined that St. Paul made a whopping 98% on this line in 1985 and that rather than propose a 136% rate increase, the company should have proposed a rate reduction of 25%.

As a result of this data, we mounted a challenge to St. Paul's rate requests and our insurance commissioner disapproved them. And what does St. Paul do? Did they reduce the rate hike request to meet reality? No, they went ahead and cancelled the policies. I have called upon our legislature to freeze premiums and initiate a study to determine where premiums are excessive or adequate. Excessive premiums would then be rolled back by the legislature to proper levels. We believe such a study would reveal that in the majority of lines of insurance existing rates are only rarely inadequate and that in the clear majority of circumstances they are excessive.

I am not here today, nor is it my role, to say whether or not our state Senate Bill 714 was right or wrong. That question can only be answered by our state legislature and our courts. However, I am here today to object to the manner in which these insurance companies, CNA and St. Paul and Ohio Hospital, have decided to attempt to perform the functions of our legislature for us. I think it important that other states recognize the degree to which the health care system of the state of West Virginia has been imperiled by the collusive and abusive actions of these companies.

That brings us to the crux of the issue as far as West Virginia is concerned. In the absence of this antitrust immunity, would these corporations have ever acted together to force the repeal of a state law designed to place them under greater regulatory scrutiny? Well, I think not. For me as an elected government official and chief law officer in our state, the frightening aspect in all this is the fact that the industry succeeded in their goal of repeal. The insurance reform provisions of our Senate Bill 714 were deleted. Now, that, I believe, is an extraordinary exercise of power. The McCarran-Ferguson antitrust exemption has served this industry well--served it well at the expense of our citizens, our businesses and our institutions.

The insurance industry is the most powerful concentration of economic force in our nation. So powerful that it remains unregulated in any meaningful sense--virtually no federal regulation and mere piecemeal, patchwork regulation at the state level by understaffed, underfunded, embattled state regulators who have consistently seen this vast and powerful industry lobby to erode and prevent significant or effective regulation.

Not only is this industry largely unregulated, but here is an industry so powerful that it has succeeded in having its activities exempted from our nation's historic antitrust laws. The McCarran-Ferguson antitrust exemption rests less upon the weak rationales offered to support it than upon the actual economic and concomitant political power of the industry itself. If West Virginia's experience of the insurance industry's anticompetitive practices is any barometer of what is happening to other states--and I believe it is--then this is truly a matter of national concern. The McCarran-Ferguson Act exemption serves no purpose other than to insulate the anticompetitive practices of this industry from scrutiny. I believe that a careful examination of history will show that the industry has consistently enjoyed and just as consistently abused the privileges granted it--privileges that have made the insurance industry the most powerful and least regulated business in the United States. The McCarran-Ferguson Act did nothing more than legitimize the unfair practices then existing withing the insurance marketplace. Today it still serves the very same purpose.

I believe that there is more collusion than competition within the insurance industry. The industry rationale, and you will hear it again today I'm sure, is that they are so heavily regulated by the states that the state regulatory structure must stand in lieu of the antitrust laws. I grant that *if* state regulation is meaningful, this rationale would have some merit. However, to the extent that state regulation is inadequate and mere pretense, their argument for the antitrust exemption rings hollow. Before I go further, I should note that both Massachusetts and New York have very vigorous state regulatory programs. They lead the nation and a few states have followed that lead, but that leaves a very weak and dismal record for the remaining 40 or 45 states and I include West Virginia among that poor record. Shortly, you will hear assertions to the contrary, but I ask you to keep in mind the following question for those who laud the record of state regulation--"if state regulation is so vigorous and effective, why then is insurance either unaffordable or unavailable?" When we draw the comparison between state regulation of utilities and state regulation of insurance, we see the following glaring difference. The public has access to telephone service, electric service and gas at a, more or less, affordable price. The same cannot be said for insurance, though it will be argued here today that the existing state framework is more than adequate.

Frankly, I believe that this industry is just too large and too powerful to be exempt from our antitrust laws. One traditional goal of our antitrust laws has always been to prevent the unfair transfer of consumer wealth to businesses who gain that transfer by unfair methods of competition or anticompetitive practices. I believe that the industry has engaged in exactly the sort of practices that those laws were designed to prevent. We have certainly seen that transfer of consumers' and purchasers' wealth.

Any solution to the problem faced by our states has to start with the repeal of the antitrust exemption in order to restore a marketplace where the norms of competitive practice accepted within the American business community can begin to apply to the insurance industry. I recognize that this is by no means the entire solution to the problem. State regulation must function in tandem with this new environment with renewed regulatory resources and with a renewed commitment to regulatory goals designed for effective and meaningful scrutiny of insurance industry behavior throughout the entire spectrum of industry activities.

I and the citizens of my state support this important step and encourage you to repeal the antitrust exemption. Thank you.

Senator **Metzenbaum**. Mr. Teitz.

Mr. **Teitz**. Thank you. I appreciate the opportunity to address the committee today on this very important issue. I am Jeffrey Teitz, the chairman of the Rhode Island House Judiciary Committee. I appear here today on behalf of the National Conference of State Legislatures to discuss with you NCSL's policy urging repeal of the insurance industry's broad exemption from the Federal antitrust laws.

At first, this issue might appear to be an unusual focus of concern for an organization of State legislators. Since the declared purpose of the McCarran-Ferguson Act is to provide for the continued regulation and taxation by the several States of the business of insurance, one would not normally expect State officials to take the lead in advocating its modification or repeal. This morning, I will attempt to explain to you why NCSL has taken that step.

We believe that the current statute is actually impeding rather than facilitating effective State regulation of the insurance industry. There are three aspects to NCSL's policy on the Federal role in the regulation of insurance.

First, we support continuation of that portion of the McCarran-Ferguson Act—specifically, Section 1012(a)—which subjects the insurance industry to regulation and taxation by the States.

Second, we support enactment of legislation, such as that proposed in the last Congress by Senator Simon, which would require all insurance companies to submit relevant data regarding their premiums, earnings, claims, and reserves to an appropriate agency of the Federal Government each year.

Third, we urge repeal of that portion of the McCarran-Ferguson Act which has been interpreted to exempt most aspects of the business of insurance from the Federal antitrust laws.

The National Conference of State Legislatures, consisting of over 7,000 lawmakers in all 50 States, adopted this position after careful consideration at our annual meeting last August. In order to be approved, it had to receive support from at least three-fourths of the States present and voting. The resolution received this overwhelming support because legislators across the country have confronted common roadblocks in attempting to address the tort liability insurance crisis.

In 1986, the Nation's State legislators considered over 1,400 bills designed to alleviate a myriad of problems prompted by steep increases in insurance premiums and by the unavailability of insurance covering certain types of risk.

Time and time again, these legislators found that they were unable to obtain the information from the insurance industry which was essential to an objective determination by them of the real causes of the crisis. Without access to this information, the capacity of the States to effectively regulate the business of insurance is seriously impeded.

Furthermore, NCSL believes that subjecting the business of insurance to Federal antitrust laws will complement rather than conflict with effective State regulation. From the perspective of the States, no blanket exemption of the business of insurance from the Federal antitrust laws is necessary or warranted. State regulation of insurance, including rate-setting and rate review procedures, does not depend for its viability on Section 1012(b) of the McCarran-Ferguson Act.

As the members of this committee well know, antitrust law contains what is known as the State action doctrine. As set forth by the Supreme Court in *Parker* v. *Brown* and reiterated in countless Federal court decisions since, the doctrine provides that actions undertaken by regulated businesses in conformance with an affirmatively expressed, clearly articulated and actively supervised State policy will not be held to violate the antitrust laws.

It is for this reason that the States can and do regulate a myriad of businesses other than insurance without coming into conflict with Federal antitrust laws.

The presence of an exemption for the business of insurance from the antitrust laws in the McCarran-Ferguson Act is far more than mere duplication of the doctrine contained in *Parker* v. *Brown.*

The State action doctrine protects only those activities which are in conformance with an affirmatively expressed and actively supervised State policy. By contrast, Federal courts have interpreted the McCarran-Ferguson Act to exempt insurance company actions from the antitrust laws without regard to the particular activities in question, whether or not they were the result of compliance with State policy.

The mere fact that insurance is regulated by the State has been considered sufficient to sanction conduct violating antitrust principles even when the suspect behavior was neither mandated nor supervised by State regulatory authority.

While the State action doctrine exempts activities carried out in furtherance of clearly established State policy, the McCarran-Ferguson exemption cloaks an entire industry in a robe of immunity.

As a result, anti-competitive insurance company behavior can presently occur free from control of either State regulators or the Federal antitrust laws. This serves neither the State nor the Federal interest in effective regulation of one of the largest industries in the Nation.

Thank you.

[Statement follows:]

STATEMENT BY

REPRESENTATIVE JEFFREY J. TEITZ
CHAIRMAN, RHODE ISLAND HOUSE JUDICIARY COMMITTEE

ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

I AM JEFFREY TEITZ, CHAIRMAN OF THE RHODE ISLAND HOUSE JUDICIARY COMMITTEE. I APPEAR TODAY ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES TO DISCUSS WITH YOU NCSL'S POLICY URGING REPEAL OF THE INSURANCE INDUSTRY'S BROAD EXEMPTION FROM THE FEDERAL ANTITRUST LAWS. I APPEAR ALSO AS A LAWMAKER WITH A KEEN INTEREST IN THE ANTITRUST ISSUE, HAVING AUTHORED RHODE ISLAND'S ANTITRUST LAW.

AT FIRST, THIS ISSUE MIGHT APPEAR TO BE AN UNUSUAL FOCUS OF CONCERN FOR AN ORGANIZATION OF STATE LEGISLATORS. SINCE THE DECLARED PURPOSE OF THE MCCARRAN-FERGUSON ACT IS TO PROVIDE "FOR THE CONTINUED REGULATION AND TAXATION BY THE SEVERAL STATES OF THE BUSINESS OF INSURANCE," ONE WOULD NOT NORMALLY EXPECT STATE OFFICIALS TO TAKE THE LEAD IN ADVOCATING ITS MODIFICATION OR REPEAL. THIS MORNING, I WILL ATTEMPT TO EXPLAIN TO THE COMMITTEE WHY NCSL HAS TAKEN THAT STEP.

WE BELIEVE THAT THE CURRENT STATUTE IS ACTUALLY IMPEDING, RATHER THAN FACILITATING, EFFECTIVE STATE REGULATION OF THE INSURANCE INDUSTRY. THERE ARE THREE ASPECTS TO NCSL'S POSITION ON THE FEDERAL ROLE IN THE REGULATION OF INSURANCE. FIRSTLY, WE SUPPORT CONTINUATION OF THAT PORTION OF THE MCCARRAN-FERGUSON ACT, SPECIFICALLY SECTION 1012(A), WHICH SUBJECTS THE INSURANCE INDUSTRY TO REGULATION AND TAXATION BY THE STATES. WE WOULD CERTAINLY OPPOSE ANY ATTEMPT IN THE CONGRESS TO DEPRIVE THE STATES OF THEIR HISTORICAL JURISDICTION IN THIS AREA. SECONDLY, WE SUPPORT ENACTMENT OF LEGISLATION SUCH AS THAT PROPOSED BY SENATOR SIMON WHICH WOULD REQUIRE ALL INSURANCE COMPANIES TO SUBMIT RELEVANT DATA REGARDING THEIR PREMIUMS, EARNINGS, CLAIMS, AND RESERVES TO AN APPROPRIATE AGENCY OF THE FEDERAL GOVERNMENT EACH YEAR. THIRDLY, WE URGE REPEAL OF THAT PORTION OF MCCARRAN-FERGUSON WHICH HAS BEEN INTERPRETED TO EXEMPT MOST ASPECTS OF THE BUSINESS OF INSURANCE FROM THE FEDERAL ANTITRUST LAWS.

THE NATIONAL CONFERENCE OF STATE LEGISLATURES, CONSISTING OF OVER 7,000 LAWMAKERS IN ALL FIFTY STATES, ADOPTED THIS POSITION AFTER CAREFUL CONSIDERATION AT OUR ANNUAL MEETING LAST AUGUST. IN ORDER TO BE APPROVED, IT HAD TO RECEIVE SUPPORT OF AT LEAST THREE-FOURTHS OF THE STATES VOTING. THE RESOLUTION RECEIVED SUCH OVERWHELMING SUPPORT BECAUSE LEGISLATORS ACROSS THE COUNTRY HAVE CONFRONTED COMMON ROADBLOCKS IN ATTEMPTING TO ADDRESS THE TORT LIABILITY INSURANCE CRISIS. IN 1986, THE NATION'S STATE LEGISLATORS CONSIDERED OVER 1400 BILLS DESIGNED TO ALLEVIATE THE MYRIAD OF PROBLEMS PROMPTED BY STEEP INCREASES IN INSURANCE PREMIUMS AND BY THE UNAVAILABILITY OF INSURANCE COVERING CERTAIN TYPES OF RISK. TIME AND TIME AGAIN, THESE LEGISLATORS FOUND THAT THEY WERE UNABLE TO OBTAIN THE INFORMATION FROM THE INSURANCE INDUSTRY WHICH WAS ESSENTIAL TO AN OBJECTIVE DETERMINATION BY THEM OF THE REAL CAUSES OF THE CRISIS. WITHOUT ACCESS TO THIS INFORMATION, THE CAPACITY OF THE STATES TO EFFECTIVELY REGULATE THE BUSINESS OF INSURANCE IS SERIOUSLY IMPEDED. ACCORDINGLY, THE NATION'S STATE LEGISLATORS ADOPTED THIS RESOLUTION:

> TO ENSURE THAT ADEQUATE AND COMPREHENSIVE DATA IS MADE AVAILABLE REGULARLY, NCSL BELIEVES THAT CONGRESS SHOULD ENACT LEGISLATION COMPELLING THE ANNUAL SUBMISSION, TO THE APPROPRIATE FEDERAL AGENCY, OF DATA THAT INCLUDES, BUT IS NOT LIMITED TO, THE FOLLOWING: (A) PREMIUMS EARNED AND WRITTEN; (B) TOTAL CLAIMS PAID REGARDING JUDICIAL DISPOSITION, SETTLEMENTS AND ADMINISTRATIVE/LEGAL COSTS; (C) RESERVES; (D) INDIVIDUAL CLASSIFICATIONS OF BUSINESS WHERE PREMIUMS HAVE INCREASED/DECREASED THE PREVIOUS YEAR; AND (E) INVESTMENT INCOME. THIS DATA SHALL BE SUBMITTED BY CLASSIFICATION OF BUSINESS AND BE COMPLETED ON A NATIONAL AGGREGATE AND INDIVIDUAL STATE AGGREGATE BASIS. STATE COLLECTION OF INSURANCE DATA AND ANNUAL FINANCIAL REPORTING REQUIREMENTS SHALL NOT BE PROHIBITED BY ANY FEDERAL LEGISLATION. ALL DATA COLLECTED NATIONALLY BY AN APPROPRIATE FEDERAL AGENCY SHALL BE DISSEMINATED TO THE STATES IN A TIMELY FASHION.

IN EACH STATE CAPITOL, LEGISLATORS ARE BEING ASKED TO CONSIDER MAKING SERIOUS ALTERATIONS IN OUR TRADITIONAL CIVIL JUSTICE SYSTEM. SOME OF THESE PROPOSALS WOULD SERIOUSLY CURTAIL THE RIGHTS OF THE INJURED PARTIES. BEFORE SUCH MAJOR LEGISLATIVE DECISIONS ARE MADE, WE MUST BE ABLE TO DETERMINE WHAT THEIR ACTUAL IMPACT ON INSURANCE PREMIUM RATES WILL BE. THIS REQUIRES INFORMATION WHICH THE STATES HAVE BEEN UNABLE TO OBTAIN. THOSE STATES WHICH HAVE ATTEMPTED TO TAKE THE LEAD WITH LEGISLATION TO COMPEL THE PRODUCTION OF RELEVANT DATA HAVE ALL TOO OFTEN BEEN MET WITH INTRANSIGENCE FROM THE INSURANCE

INDUSTRY. FURTHERMORE, MANY OF THE INDUSTRY DECISIONS THAT IMPACT ON A PARTICULAR STATE ARE THE RESULT OF FACTORS BEYOND THE REACH OF THAT STATE'S LEGISLATORS AND REGULATORS. FOR THESE REASONS, NCSL BELIEVES THAT SUBJECTING THE BUSINESS OF INSURANCE TO FEDERAL ANTITRUST LAWS WILL COMPLEMENT, RATHER THAN CONFLICT, WITH EFFECTIVE STATE REGULATION.

FROM THE PERSPECTIVE OF THE STATES, NO BLANKET EXEMPTION OF THE BUSINESS OF INSURANCE FROM THE FEDERAL ANTITRUST LAWS IS NECESSARY OR WARRANTED. STATE REGULATION OF INSURANCE, INCLUDING RATE SETTING AND RATE REVIEW PROCEDURES, DOES NOT DEPEND FOR ITS VIABILITY ON SECTION 1012(B) OF THE MCCARRAN-FERGUSON ACT. AS THE MEMBERS OF THIS COMMITTEE WELL KNOW, ANTITRUST LAW CONTAINS WHAT IS KNOWN AS THE "STATE ACTION DOCTRINE." AS SET FORTH BY THE SUPREME COURT IN PARKER V. BROWN, 317 U.S. 341 (1943), AND REITERATED IN COUNTLESS FEDERAL COURT DECISIONS SINCE, THE DOCTRINE PROVIDES THAT ACTIONS UNDERTAKEN BY REGULATED BUSINESSES IN CONFORMANCE WITH AN AFFIRMATIVELY EXPRESSED, CLEARLY ARTICULATED, AND ACTIVELY SUPERVISED STATE POLICY WILL NOT BE HELD TO VIOLATE THE ANTITRUST LAWS. IT IS FOR THIS REASON THAT THE STATES CAN AND DO REGULATE - SET RATES, ALLOCATE TERRITORIES, AND CONTROL COMPETITION - IN A MYRIAD OF BUSINESSES OTHER THAN INSURANCE WITHOUT COMING INTO CONFLICT WITH FEDERAL ANTITRUST LAW.

THE NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES ESTABLISHED BY THE ATTORNEY GENERAL A DECADE AGO REACHED THIS CONCLUSION:

> THE CURRENT BROAD ANTITRUST IMMUNITY FOR THE BUSINESS OF INSURANCE GRANTED BY THE MCCARRAN-FERGUSON ACT SHOULD BE REPEALED... THE COMMISSION BELIEVES THAT THE CURRENT IMMUNITY IS NOT ONLY OVERLY BROAD, BUT ALSO UNNECESSARY. THOSE COLLECTIVE ACTIVITIES BY INSURERS THAT ARE ESSENTIAL TO THE FUNCTIONING OF A COMPETITIVE INDUSTRY WOULD LIKELY PASS MUSTER UNDER THE TRADITIONAL RULE OF REASON ANALYSIS OF SHERMAN ACT, SECTION ONE. SIMILARLY, WHERE COLLECTIVE ACTIVITY OR OTHER INSURANCE COMPANY BEHAVIOR IS AFFIRMATIVELY MANDATED BY THE STATE IN ITS CAPACITY AS SOVEREIGN, AND EFFECTIVELY SUPERVISED BY INDEPENDENT STATE OFFICIALS, SUCH BEHAVIOR WOULD FALL WITHIN THE JUDICIALLY RECOGNIZED STATE ACTION EXEMPTION TO THE ANTITRUST LAWS.

THE PRESENCE OF AN EXEMPTION FOR THE BUSINESS OF INSURANCE FROM THE ANTITRUST LAWS IN THE MCCARRAN-FERGUSON ACT IS FAR MORE THAN MERE DUPLICATION OF THE DOCTRINE CONTAINED IN PARKER V. BROWN. STATE ACTION DOCTRINE PROTECTS ONLY THOSE ACTIVITIES WHICH ARE IN CONFORMANCE WITH AN AFFIRMATIVELY EXPRESSED AND

ACTIVELY SUPERVISED STATE POLICY. BY CONTRAST, FEDERAL COURTS HAVE INTERPRETED MCCARRAN-FERGUSON TO EXEMPT INSURANCE COMPANY ACTIONS FROM THE ANTITRUST LAWS WITHOUT REGARD TO WHETHER THE PARTICULAR ACTIVITIES IN QUESTION WERE THE RESULT OF COMPLIANCE WITH SUCH A STATE POLICY. THE MERE FACT THAT INSURANCE IS "REGULATED BY STATE LAW" HAS BEEN CONSIDERED SUFFICIENT TO SANCTION CONDUCT VIOLATING ANTITRUST PRINCIPLES, EVEN WHEN THE SUSPECT BEHAVIOR WAS NEITHER MANDATED NOR SUPERVISED BY THE STATE REGULATORY AUTHORITY. WHILE THE STATE ACTION DOCTRINE EXEMPTS ACTIVITIES CARRIED OUT IN FURTHERANCE OF CLEARLY ESTABLISHED STATE POLICY, THE MCCARRAN-FERGUSON EXEMPTION CLOAKS AN ENTIRE INDUSTRY IN A ROBE OF IMMUNITY. AS A RESULT, ANTICOMPETITIVE INSURANCE COMPANY BEHAVIOR CAN PRESENTLY OCCUR FREE FROM CONTROL BY EITHER STATE REGULATION OR FEDERAL ANTITRUST LAW. THIS SERVES NEITHER THE STATE NOR THE FEDERAL INTEREST IN EFFECTIVE REGULATION OF ONE OF THE LARGEST INDUSTRIES IN THE NATION. THE AMERICAN PEOPLE PAID OVER $140 BILLION LAST YEAR IN PREMIUMS ON PROPERTY-CASUALTY INSURANCE ALONE. TO EXEMPT SUCH A MAJOR INDUSTRY FROM THE ANTITRUST LAWS DOES NOT SERVE THE PUBLIC INTEREST.

PARTICULARLY AT A TIME WHEN LIABILITY INSURANCE PREMIUMS ARE RISING SO STEEPLY, IT SHOULD NOT BE LEGAL FOR INSURANCE COMPANIES TO FIX PRICES. ESPECIALLY AT A TIME WHEN THE AVAILABILITY OF CERTAIN LINES OF INSURANCE IS BEING CURTAILED, THE INDUSTRY SHOULD NOT BE FREE TO ENTER INTO ELABORATE MARKET ALLOCATION SCHEMES. CERTAINLY, AT A TIME WHEN INSURANCE COMPANIES ARE THREATENING TO WITHDRAW FROM STATES IF THEIR LEGISLATURES DARE TO ENACT TOUGH NEW REGULATORY PROPOSALS, IT SHOULD NOT BE LAWFUL FOR THESE COMPANIES TO ENGAGE IN A CONSPIRACY TO BOYCOTT THOSE STATES. IN EVERY OTHER INDUSTRY IN AMERICA, SUCH ACTION WOULD BE CRIMINAL. WHY IN THE BUSINESS OF INSURANCE SHOULD IT BE SANCTIONED?

JUSTICE OLIVER WENDELL HOLMES REFERRED TO ANTITRUST LAWS AS: "THE MAGNA CARTA OF THE FREE ENTERPRISE SYSTEM." JUST AS THE INDIVIDUAL RIGHTS FIRST ENUNCIATED IN THAT GREAT DOCUMENT NOW APPLY EQUALLY TO ALL CITIZENS, THE RULES OF FAIR COMPETITION IN THE MARKETPLACE SET FORTH IN THE SHERMAN AND CLAYTON ACTS SHOULD APPLY EQUALLY TO ALL BUSINESSES, INCLUDING THE BUSINESS OF INSURANCE.

Senator **Metzenbaum**. Thank you very much, Mr. Teitz.

Before proceeding to questions, the chairman of the overall committee is with us and I think he has an opening statement. We are very happy to hear from Senator Biden.

OPENING STATEMENT OF CHAIRMAN BIDEN

The **Chairman**. We are beginning all over again here, gentlemen. Senator Metzenbaum has introduced a bill that is going to force us to focus on the different aspects of what obviously is a very complex problem. One of the questions is: Has the historical system of insurance regulation, most particularly the exemption from the antitrust laws that the industry enjoys, contributed in any significant way to the degree of shortage or the skyrocketing costs of liability insurance?

On two different occasions now since I have been a United States Senator, the Justice Department has recommended that the antitrust immunity afforded by the McCarran-Ferguson Act be repealed or limited.

I have great respect for the individuals who did those studies, and I am interested in learning why those conclusions were reached and in reexamining it. It has been almost a decade since this question has been addressed in this committee, and certainly times have changed.

Could we have avoided the crisis which is upon us now if some of those recommendations had been heeded? Well, I am not sure. Is reform of this 40-year-old statute a part, albeit a difficult part, of the solution that we are trying to search for and that we debated last year in the so-called tort reform legislation?

Well, at this stage, quite frankly, I really do not know, but we owe it to ourselves and to the American people to find out. I would like to congratulate the distinguished Senator from Ohio for striking out on this rough road. He is used to rough roads.

I encourage him to join with others of his colleagues on this committee in an effort to piece together what is one of the most complex puzzles that we face. I am hopeful that in the weeks ahead we will begin to consider other aspects of the problem as well, such as the handling of mass torts or the management of complex litigation or alternative means of resolving disputes other than through expensive litigation.

But the bottom line of all of this, to use that trite Washington expression, is that it is about time we get this underway. I congratulate the Senator from Ohio for doing so, and I can assure him he will have my full cooperation, as chairman of the full committee, in having all the hearings and all the cooperation to get through his bill, which I still have an open mind about.

I am waiting for the Insurance Commissioner from Delaware to tell me what I am to do on this. He is going to be one of the next witnesses, and after that I will make up my mind.

But all kidding aside, I congratulate the chair, and I look forward to having an opportunity to question these witnesses. Mr. Chairman, I have about 8 or 10 questions for the Justice Department. I would like to ask that they be submitted to the Department. I understand they have already had to leave.

I have nothing further to say at this time.

Senator **Metzenbaum**. Without objection, so ordered. The questions will be submitted to the Justice Department and we will expect them to respond.

Are those also for the FTC?

The **Chairman**. Yes, they are also for the FTC.

[Response to questions follow:]

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General
Washington, D.C. 20530

MAR 20 1987

Honorable Joseph R. Biden, Jr.
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter is in response to your letter of February 19, 1987, requesting answers to several questions relating to the McCarran-Ferguson Act that you did not have an opportunity to pursue at the Committee's February 18 hearing. I am pleased to respond to these questions for the record.

Question 1: Are you familiar with the report of the tort policy working group which was released in February, 1986? Were you a part of that task force, which was headed by Richard Willard from the Civil Division?

Answer: I am familiar with the February, 1986, Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability. Although the Antitrust Division was not a member of the Working Group, I and other senior Division personnel consulted with the Civil Division during the preparation of the 1986 Report.

Question 2: That report summarily dismisses McCarran-Ferguson Act repeal or reform as part of the solution to the so-called liability crisis. However, in 1977 and again in 1979, the Antitrust Division strongly recommended that repeal,--or at the very least, limitation of the McCarran Act's antitrust immunity for the insurance industry--would be in the public interest. What accounts for the marked difference in views?

Answer. I have no reason to disagree with the conclusions in the 1986 Report with respect to the likely causes of the current crisis in certain lines of insurance. The Working Group found no evidence to support the hypothesis that the current antitrust immunity for the business of insurance has played a significant role in the development of this crisis. As my prepared statement indicates, the Antitrust Division has not seen any direct evidence that collusion fostered by antitrust immunity is a significant cause of the crisis, and circumstantial evidence suggests to the contrary. The generally unconcentrated structure of the industry and the evolution of state laws that allow free play for price competition in property-liability insurance make collusion far less likely an explanation for affordability or availability problems in the crisis lines than the increases in loss payouts and the variability of those losses that appear attributable to problems with the current tort liabiliity system.

These conclusions do not conflict with the views of the Division in 1977 that are reflected in the Department's Report on the Pricing and Marketing of Insurance, or with the 1979 Report of the National Commission for the Review of Antitrust Laws and Procedures. The Department's 1977 Report, and I should note that I do not agree with all of the conclusions and recommendations in that report--in particular with those calling for an increased federal role in insurance regulation, and the Commission's 1979 Report focused on the wisdom of repealing or modifying the McCarran-Ferguson antitrust immunity generally, rather than on any relationship between that immunity and the relatively sudden and severe affordability or availablity problems in particular lines of insurance that we have been experiencing in the last few years. As I indicated in my prepared statement, there are reasons for considering legislation that would eliminate or modify the exemption apart from any connection to the current crisis in some insurance lines. Thus, while we support reconsideration of the McCarran-Ferguson antitrust exemption, we do not believe that repeal of the broad antitrust immunity will solve the problems currently confronting liability insurers and their customers.

Questions 3 - 5:

3. No one made mention of the excessive competition in 1979, when the first signs of a crisis in the cost and availability of liability insurance could be clearly seen. Although the National Commission for Revision of the Antitrust Laws acknowledged that the insurance industry was competitively structured, the recommendation was made in no uncertain terms that the broad antitrust immunity granted by McCarran-Ferguson be repealed. It was stated that the exemption served no federal or state objective, was not necessary for the effective function of the industry and permitted insurers and state regulators to avoid any inquiry into the appropriate limits that should be placed on insurance companies collective activities.

4. Do you believe that McCarran-Ferguson serves any federal or state regulatory objective?

5. Do you believe that any limits should be placed on the collective or collaborative activities engaged in by insurance companies?

Answer: Certain provisions of the McCarran-Ferguson Act serve to delimit the role that the federal government plays in the regulation of insurance and to clarify the primacy of regulation at the state level. As I indicated in my prepared statement, I believe that these provisions should be left untouched if Congress decides to repeal or amend those other provisions in the Act that specifically establish antitrust immunity for the business of insurance. One purpose of the antitrust immunity itself, of course, was to protect state regulation, as well as collective activities among insurers that were thought to be procompetitive or otherwise in the public interest and that were seen as threatened by the South-Eastern Underwriters decision. As I indicated in my prepared statement, however, state regulation as a general matter is protected by "state action" antitrust immunity, a doctrine far better understood now than it was when the McCarran-Ferguson Act was passed. Similarly, substantive antitrust analysis has come a long way in being able to distinguish between procompetitive and anticompetitive collective activities, including activities that have some relationship to price.

I believe that some collective or collaborative activities among insurers can harm consumers. This is not to say, however, that all such activities are anticompetitive and should be enjoined. Many collective activities actually may enhance the ability of the industry, perhaps particularly its smaller members, to get the information they need to offer coverage to consumers in an efficient manner or to join together in providing coverage beyond the ability of any one company. These and other procompetitive collective activities, would not, I believe, ultimately be found to violate the antitrust laws, but as I indicated in my prepared statement, it is appropriate for Congress carefully to consider the extent of any uncertainty here and the various methods of resolving such uncertainty that have been suggested as complements to repeal of the current broad immunity.

I hope these answers will be useful to you and to the other members of the Committee. If we can be of further assistance, please let us know.

Sincerely,

Charles F. Rule
Acting Assistant Attorney General

Senator **Metzenbaum**. Senator Thurmond.

Senator **Thurmond**. I have no questions. Thank you very much.

Senator **Metzenbaum**. Senator Heflin.

Senator **Heflin**. I believe, Mr. Brown, you said that there was a wholesale cancelation of malpractice insurance in your State.

Mr. **Brown**. Yes, Senator.

Senator **Heflin**. Did this apply to doctors and to hospitals, all health care units?

Mr. **Brown**. It applied to virtually every health care provider in the State. There were a few small companies that sold, for example. People who lived on the border of the State might be buying from a company on the other side of the State line, and a couple of companies stayed in, but the overwhelming majority of policies were canceled and there was nowhere else people could go to buy them.

Senator **Heflin**. Now, you testified that you filed an injunction within 48 hours of the cancelation date. Were you successful in getting that injunction?

Mr. **Brown**. Our supreme court—and you know a lot about supreme courts—our supreme court granted the injunction, Senator Heflin.

Senator **Heflin**. All right, so what is the present status of that litigation?

Mr. **Brown**. The litigation is pending. The trial has not yet been held on the issue, since we did receive the preliminary injunction last year.

Senator **Heflin**. Well, what is your opinion of the State law pertaining to that matter? Do you think that law is adequate for you to be able to stop such wholesale cancelation?

Mr. **Brown**. No, I do not. First of all, the defendants used the McCarran-Ferguson Act as a shield, removed the case to Federal court when we had filed it, because this went through a several-week period before we got the injunction.

The boycott count that we alleged was retained by the Federal judge. He said boycott was an exclusive Federal remedy and had preempted our State law, so we had to allege everything for a boycott, a concerted restraint of trade, and so on, and concerted activity, and we did get the injunction on the other grounds.

So McCarran-Ferguson was a shield used. That is reason number one that McCarran-Ferguson hurt us. Reason number two is if there had not been a McCarran-Ferguson Act, I really doubt if this whole mass withdrawal would have happened because they would have had to face the United States government.

The insurance industry gambled that our two-lawyer antitrust division, I think, would not be any major threat to them. They guessed wrong, obviously, because we did respond, but I think if the resources of the Department of Justice and the Federal Trade Commission had been there, they would not have even attempted to do what they did.

Senator **Heflin**. Well, under the McCarran-Ferguson Act, the antitrust exemption does not apply when there is a boycott.

Mr. **Brown**. Right.

Senator **Heflin**. Have you taken steps in the Federal court to allege that it was a boycott?

Mr. **Brown**. We preferred to keep our injunction case in State court, Senator Heflin, so the Federal judge retained the boycott part of the case and sent the rest of the case back to State court, the remainder of the allegations. So we pursued the remainder of the allegations in State court and let the boycott allegation remain in the breast of the Federal court.

Senator **Heflin**. Well, do you think that you can prove that it was a boycott?

Mr. **Brown**. Under State law, we will have to prove it is something other than a boycott because a Federal judge will not let us proceed on a boycott. We can proceed on everything else. Yes, we think we can prove that.

Senator **Heflin**. But in the Federal suit where boycott is retained, do you feel that you can succeed in proving that?

Mr. **Brown**. We think we could succeed, yes, although we plan to pursue the case in State court first. But I think we would have a good chance to do that, yes.

Senator **Heflin**. Well, then, under existing law as it applies to boycotts, you either have a remedy in federal court or, on the other hand, your State laws based on non-boycott. Do you think that would be adequate?

Mr. **Brown**. I think our resources are clearly inadequate to deal with the problem, although in that case they were adequate enough. Secondly, I simply think that, as with all antitrust enforcement, it would be better to have the Federal government involved.

But for that particular problem, yes, our resources were there, the law was there, and we were able to succeed in bringing the result that we wanted, which was an injunction.

Senator **Heflin**. Well, have you sought help before the Department of Justice on the boycott as it would pertain to the Federal courts?

Mr. **Brown**. No, we have not.

Senator **Heflin**. That is all.

Senator **Metzenbaum**. Well, Mr. Brown, is there not another part of this whole picture? Is it not the fact that notwithstanding the fact that you got an injunction that the legislature caved in and changed the law in order to accommodate the insurance industry?

Mr. **Brown**. Yes. That is in the full testimony there. The law was changed and most aspects of insurance reform were repealed by the legislature, who still felt they were under the gun because all we had gotten was a temporary restraining order, an injunction.

So the insurance industry did succeed in about 75 percent of their goal when the legislature came back in emergency session only to address the problem of the insurance industry. Thank you for pointing that out.

Senator **Metzenbaum**. The action of the insurance companies came about because the legislature attempted to enact some reform laws having to do with the insurance industry.

The industry then pulled out of the State as far as malpractice was concerned. Then the legislature came back and changed the law pretty much along the lines of the way the industry wanted it. Is that accurate?

Mr. **Brown**. That is correct, and since such a small part of their national business was in West Virginia, they could point out to the other 49 legislatures, look what we did to West Virginia; we put a gun to their head and they changed their laws, so you legislators better not tinker with insurance reform or you will find your health care system brought to its knees like we proceeded or tried to do in West Virginia.

Senator **Metzenbaum**. Mr. Teitz, do you have anything you want to add on that particular subject?

Mr. **Teitz**. Yes, I do. The unfortunate experience of West Virginia is one of the instances that has put this matter so much in the minds of State legislators across the country.

We feel that the concerted pressure that can be brought to bear by the insurance companies, especially if it is focused on a relatively small jurisdiction such as West Virginia or, for example, my own State of Rhode Island, is tremendous.

At the time of the 1974 medical malpractice crisis, all of the private insurance companies elected to withdraw from Rhode Island in a dispute over whether they would be forced to continue to write policies tying to the occurrence of the malpractice event or whether they could go to claims made, which was the time frame that they sought.

We in Rhode Island were forced to replace the private market with a State-created joint underwriting association which was backed by the State and thus became a substitute source of malpractice insurance.

The private medical malpractice insurance industry left the State of Rhode Island in 1975 and has not returned, and we were able to successfully replace it because you were talking about a relatively small market compared to some other lines of insurance.

However, there is no question in my mind that what the State of Rhode Island witnessed in 1975, just as what the State of West Virginia witnessed recently, was a concerted attempt by the insurance industry to really blackmail a State into not adopting regulations which that State viewed to be in the interest of the consuming public.

Senator **Metzenbaum**. Are the insurance companies now writing malpractice insurance in Rhode Island?

Mr. **Teitz**. They are not writing medical malpractice insurance. They permanently left the market as a result of this dispute.

Senator **Metzenbaum**. It has driven the State into the business of insurance?

Mr. **Teitz**. Exactly. They felt they would force us to back down. We fortunately were able to devise another remedy and they have stayed out of the market in Rhode Island.

But in my opinion, the events we saw a decade ago represented a classic antitrust conspiracy which could not have occurred but for the McCarran-Ferguson law.

Senator **Metzenbaum**. Do you know if that has occurred in any States other than Rhode Island and West Virginia?

Mr. **Teitz**. I know that in a number of jurisdictions there have been joint underwriting associations created to provide alternative sources for medical malpractice insurance. I do not know that there has been another jurisdiction where the malpractice insurers have completely removed themselves from the market.

But there is one other point on this issue that I think is important to make. We oftentimes hear from the insurance industry how competitive that industry is and how many companies there are writing insurance, and I suggest to the committee that the meaningful way to look at competition in the insurance industry is not to look at the industry as a whole but to look at each line of insurance.

Medical malpractice, for instance, is a line of insurance where the number of companies writing on a national basis is very small, and therefore there is much greater potential for this type of antitrust conspiracy to occur than in some other line of insurance such as a general homeowner's policy where there may be many, many more companies competing.

Senator **Metzenbaum**. Senator Grassley.

Senator **Grassley**. Mr. Teitz, your testimony indicated you want repeal of the antitrust exemption but you still want to maintain basic State regulation of the insurance industry.

Are you arguing that that should be maintained pretty much as is, as predominantly a responsibility of the States, or that the Federal Government ought to move in with some regulation?

Mr. **Teitz**. It is our position, Senator, that the type of regulation of the insurance industry which has traditionally been performed by the States should remain a State responsibility, and Section 1012(a) of the McCarran-Ferguson Act which explicitly reserves to the States that power to regulate and tax should remain the law of the land.

However, we believe that vigorous antitrust enforcement at the Federal level on the insurance industry would complement, not conflict with that State regulation, because oftentimes what you have is small State regulatory entities faced with national insurance companies that have tremendous resources.

We feel that there would be decisions produced that would be far more in the public interest if those national insurance companies could not engage in antitrust violations, price-fixing, allocation of markets, withdrawing from selective markets in response to State initiatives.

Senator **Grassley**. So that as far as further Federal Government involvement in the insurance industry, you would expect the discipline that would come from threat of an antitrust suit to be all the Federal Government involvement necessary. You are not asking for Federal agencies or the Attorney General, for a massive amount of Federal law and regulation in detail?

Mr. **Teitz**. We are asking for two things. We are in support of Federal data collection because the States have found it extraordinarily difficult to obtain the relevant data from the insurance industry which legislators feel they need to analyze the impact of various proposed alterations in the civil justice system.

We are being asked to make some very substantial changes in the State civil justice systems, many of which would seriously impair the rights of injured parties, and we are being asked to do that on the proposition that there will be greater insurance availability and that the price of insurance policies will be reduced if we make those changes.

However, we in the State of Rhode Island—and from a number of discussions I have had with legislators around the country, it is a national problem—have never been able to obtain from the insurance industry the type of information which would allow us to make an independent determination on whether events in the legal system have caused the so-called liability insurance crisis or whether that crisis has, in fact, been caused by internal actions within the insurance industry.

So we are asking the Federal government to force the industry on a national basis to report that type of data, make it available to the States, again, so we can more effectively carry out our responsibilities. We view that as complementary rather than in conflict with the States.

Senator GRASSLEY. I would ask each of the attorneys general, then, are you asking for any change in basic regulation of the insurance industry by the States?

Mr. SHANNON. Senator, we are not. We believe that from a law enforcement perspective, the fact that you cannot even threaten any kind of major lawsuit unless there has been an egregious activity by an insurance company, a boycott, and if there is no threat of Department of Justice action, it makes it very, very difficult to properly regulate the insurance industry and to protect the consumers.

So we are looking for that and looking for nothing more. I think that the States have primarily played the role of regulating the insurance companies and they should continue to do so.

Senator GRASSLEY. Okay. For instance, is the suggestion of Representative Teitz' organization of legislators going further than you would want to go in the sense that he is asking that the Federal government force the submittal of data for State legislators and State insurance commissioners to make——

Mr. SHANNON. We are interested just in the repeal of the antitrust exemption for the insurance industry.

Senator GRASSLEY. So you do not have a position on that?

Mr. SHANNON. We have no position on that.

Mr. BROWN. That is right, no position on data collection or on other tort issues and insurance reform issues.

Senator GRASSLEY. Well, would Representative Teitz' proposal of asking for minimum information go too far in the way of further Federal government involvement in the insurance industry?

Mr. SHANNON. I do not think our organization has a position on that, Senator. We believe that the States should play the dominant role in regulating the insurance industry and that we need the help of the Federal antitrust laws in order to do that.

Senator GRASSLEY. Thank you.

Senator METZENBAUM. Senator Biden.

The CHAIRMAN. General Brown, I am a little confused. Let us assume that your State legislature had had the will and had not buckled. What would have happened?

Mr. BROWN. Senator Biden, we had a temporary injunction which was in effect for 30 days. We managed to get that extended for about 90 more days during the course of the litigation.

I would assume that our injunction would have expired. We would have had to have won the case and gotten a permanent injunction, but I do not think realistically you can have a long-term solution forcing somebody to continue to do business in any part of the country.

So I think what would have happened is ultimately we would have lost and ultimately they would have pulled out. A temporary injunction is easy for a court to issue, to say you have got to stay here pending a longer-term solution to the problem.

The CHAIRMAN. General Shannon, there are a variety of collective or cooperative activities that are immune from the scrutiny of the Federal antitrust laws as a consequence of McCarran-Ferguson. These include rate-making, pooling of statistical data, developing standardized forms and policies, and joint underwriting and risk-sharing agreements.

Which of these do you consider to be the most unproductive or harmful to the consumer that you are attempting to protect, or are they all in the same boat?

Mr. SHANNON. First of all, Senator, I am not convinced at all that the kinds of activities that insurance companies have historically participated in as a matter of course in doing business would be illegal under antitrust law if you removed the exemption. So I think that is really a kind of a red herring.

To the degree that the insurance companies say that they need some kind of special treatment under antitrust laws, I think that they should have the opportunity to come and make their case to this committee that that special treatment is warranted and that they need that.

But I think that there are lots of activities, the ones that you have outlined included, that insurance companies engage in which would not be illegal under antitrust law if you were to repeal this exemption, and I think that they could live with that.

The CHAIRMAN. Are there any that would be illegal that you think should be made legal? In other words, you all are here asking for total repeal of the antitrust exemption. Did you examine whether or not there are any activities which, if McCarran-Ferguson were repealed, would warrant being exempted?

Mr. SHANNON. I have not seen, and I do not think the Association has seen, any activities which insurance companies need to engage in as a matter of course in doing business which should require a special exemption.

As I said, if they can make that case, they should be entitled to do that, but I do not believe that there are any special activity exemptions that they should be allowed.

Mr. BROWN. Speaking for myself, Senator Biden, I think the rating bureaus would pose a problem, not the collection of data, but then the joint recommendation by the rating bureau to the commissioner of what the price would be.

Now, Illinois has operated for over a decade without allowing their rating bureaus to recommend any rates. All that the rating bureau does is collect information for the industry, and that can be done; that is in the nature of a joint venture or it would be in the nature of simply collecting industry data which, under the *Maple Flooring* case, is certainly allowed.

I think the insurance exemption, if we repeal that, it would knock out rating bureaus being allowed to propose rate increases, and I would personally like to see rating bureaus prohibited from proposing joint rates.

The CHAIRMAN. Mr. Chairman?

Mr. TEITZ. It is our opinion, Senator, that those activities which are joint activities, such as the sharing of loss data, could continue even if the insurance industry were subject to the McCarran-Ferguson Act.

The CHAIRMAN. Even if it were not subject to it; even if it were exempt?

Mr. TEITZ. Even if it were subject to the antitrust laws and the McCarran-Ferguson exemption were repealed.

I would share the opinion of General Brown that joint rating, as opposed to sharing of loss data, would probably become a violation were McCarran-Ferguson repealed, and I believe it should be illegal. I do not believe that the industry can make a compelling case for why it should be allowed to make rates jointly, which is, in essence, price-fixing, as opposed to merely sharing their loss experience which gives them a broader base of analysis upon which each company should independently set rates.

I would call to this committee's attention that that opinion is not only ours, but is the opinion of the Justice Department commission which, in 1979, reviewed this issue and concluded that McCarran-Ferguson should be repealed and said, in part:

> Those collective activities by insurers that are essential to the functioning of a competitive industry would likely pass muster under the traditional rule of reason analysis of Sherman Act Section 1; similarly, where collective activity or other insurance company behavior is affirmatively mandated by the State in its capacity as sovereign and effectively supervised by independent State officials, such behavior would fall within the judicially recognized State action exemption to the antitrust laws.

What we are saying, in essence, is that there is already in place in antitrust doctrine sufficient latitude for those joint activities that are truly in the public interest to continue.

I think the burden is on the industry to come forward and show particular activities which should be, in the public interest, continued which would be prevented by those laws, and if they do, then the Congress should deal with that on a narrow basis. Rather than exempting an industry, it should deal with each activity very specifically. But to date, I have heard from the industry no example of an activity that I think needs special protection.

The CHAIRMAN. Mr. Chairman, my time is up. I have a series of questions for the attorneys general who are here today, asking for their views on the question of how litigious a society we have become. I hear all these phenomenal statements about how we are so litigious. I find, unsolicited, coming to me from law school deans all around the country evidence of the fact that, comparatively speaking, we are not nearly as litigious as some other societies, number one. And number two, the degree to which civil litigation has increased in the courts is directly proportionate to the increase in population. I do not think we know which is the case.

I have some questions asking for their particular insights into this matter. I will not take the committee's time now, but I will submit the questions in writing, and I would appreciate it—I do not want to make work for you fellows; I know you have plenty enough to do at home. But if you would respond to them, I would appreciate it very much.

Mr. **Shannon**. We are certainly glad to, Senator.

[Response to questions follow:]

THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF THE ATTORNEY GENERAL
JOHN W. McCORMACK STATE OFFICE BUILDING
ONE ASHBURTON PLACE, BOSTON 02108-1698

JAMES M. SHANNON
ATTORNEY GENERAL

April 3, 1987

Honorable Joseph R. Biden, Jr.
Chairman
United States Senate
Committee on the Judiciary
Washington, DC 20510

Dear Senator Biden:

I appreciate the opportunity to expand upon the comments I presented to the Senate Judiciary Committee on February 18, 1987 regarding the McCarran-Ferguson Act. I believe that the questions you have posed in your letter of February 19, 1987 are important ones, and I have attempted to answer them fully in the attached statement.

I am pleased to present this additional information for your consideration. I commend the work of your Committee in this complex area, and look forward to continuing to work with you where I can be of help.

Very truly yours,

JAMES M. SHANNON
ATTORNEY GENERAL

JMS/mo
Enclosure

RESPONSES OF ATTORNEY GENERAL JAMES M. SHANNON
To Questions Posed by Senate Judiciary Committee
Chairman Joseph E. Biden
Following Hearing On The McCarran Ferguson Act,
February 18, 1987

Q#1. Many people are concerned about the amount of society's resources being spent on liability litigation, but no one really has hard facts to support their views. Everyone likes to talk about how litigious Americans have become, but no reliable statistics are really available. As state Attorney General, what are you doing to ascertain the situation in your state?

A: I agree that participants in the debate about liability and insurance frequently refer to increased litigiousness without having the facts to support their assertions. Reliable statistics are hard to come by, and one obvious solution for the future is to start collecting important statistics now, so that a reliable database can be developed over time.

In Massachusetts, as in many states, a task force appointed by the Governor has examined the availability and affordability of liability insurance. The Attorney General's office has been a member of that task force. One of the task force's final recommendations, which I thoroughly endorse, is that legislation should be enacted at the state level to require liability insurers to provide line-by-line Massachusetts data on losses, premiums, trends in the number of claims and lawsuits filed, the size of settlements and awards entered, and other data deemed necessary by the Commissioner of Insurance. In fact, my office has recently filed legislation to require all property/casualty insurers doing business in the Commonwealth to file annual closed claim studies providing detailed information on claims, litigation, awards, payouts, settlements and reserves. I also believe that funding for the Commonwealth's Division of Insurance should be increased to allow the collection and analysis of these data.

My office also has been active in searching out and collating the limited state court statistics that are currently available to aid in our own analysis of litigation rates in Massachusetts. While data for past years is difficult to obtain, Massachusetts courts have recently begun collecting more comprehensive case data. I am hopeful that this will enable more meaningful analysis in the future.

Q#2. Do you believe that there has been a liability litigation explosion or do you believe that the growth in the number of cases is merely consistent with the growth in the population?

A: The best evidence I have seen about Massachusetts and the country as a whole does not support the conclusion that liability litigation has "exploded". In many instances, the number of tort cases filed has actually decreased or remained contant. Where an increase has been documented, it has often been steady and predictable over the years and consistent with factors such as population growth. For example, the annual reports of the Superior Court in Massachusetts (the primary trial court for the Commonwealth) indicate that civil case filings rose only 2.1% between 1979 and 1985, or an annual rate of increase of only 0.3%. Similarly, tort filings in the Superior Court have remained essentially constant, rising less than 2% from fiscal years 1984 through 1986, and actually declining 3% between 1984 and 1985. During this same period, product liability filings held steady at about 3% of annual tort filings.

Finally, the annual reports of my office, which defends the Commonwealth of Massachusetts when it is sued, show that there has been a 15% increase in tort filings against the Commonwealth since fiscal year 1980, or only a 2.4% annualized increase. In fiscal years 1984-86, there was an 18% decrease in such filings.

On a national basis, the evidence is similar. In the state courts nationwide, the best available data show only a 9% increase in tort filings in the six years between 1978 and 1984, barely more than the 8% population increase for that period. (National Center for State Courts, State Court Caseload Statistics: Annual Report, 1984 (1986)). Additionally, the reported 758% increase in product liability lawsuits in the federal district courts between 1974 and 1985 has limited significance, since only approximately 2% to 5% of all litigation takes place in federal court.

The need for a final warning is clear from these figures. As emphasized in the 1984 annual report of the Massachusetts courts, "Because the volume and composition of caseloads constantly changes as a reflection of underlying social, economic and demographic factors, a simplistic comparison of gross annual statistics may be somewhat misleading." Population growth is only one of many factors that can and do account for changes in litigation patterns. These factors may include predictable effects of the passage of time (such as demographic changes), or desirable consequences of advancing technology or legal change (such as the increased ability of victims of toxic torts to trace the source of their injuries.) Increases in litigation statistics alone may tell us little about the legitimacy or desirability of those increases.

Q#3. What kinds of cases have increased -- medical and other kinds of professional malpractice? Torts involving toxic and hazardous materials? Torts involving automotive vehicles?

A: The absence of good data makes it difficult to document increases -- or decreases -- in litigation within particular subject areas. I am aware of some information relevant to your question, however. For example, while Boston has experienced a significant increase in civil rights lawsuits against the city from 1982 through 1985, there was no increase during this period in personal injury or property damage cases filed. Similarly, the Commonwealth's Division of Insurance recently predicted, in the context of a hearing on medical malpractice insurance rates, that malpractice claims would increase by only 1.8% for the period July 1987 through July 1988, based on the most recent five years' data.

There is some indication of an increase in product liability cases filed in Federal District Court in Masachusetts. Analysis reveals, however, that much of this increase is attributable to asbestos litigation. Between 1976 and 1983, product liability filings rose from a low of 83 to a high of 673. In 1984 through 1986, however, the first period for which asbestos and non-asbestos cases were separated, the reason for this earlier increase became clear. From 1984-86, non-asbestos cases rose from only 177 to 236, while asbestos cases rose from 599 to 985 (in 1985) and then fell to 262 (in 1986). Massachusetts has the dubious distinction of hosting the largest number of asbestos cases of any state, possibly because of the importance of shipbuilding to its economy in recent decades. While other product liability filings also have increased, these increases have been nowhere near as precipitous or substantial as they first appear once asbestos litigation is accounted for separately.

Q#4. The Rand Institute on Civil Justice has just released a major study of the costs and compensation in tort litigation. The study looked at nearly 900,000 tort lawsuits terminated in state and federal court in 1985. It found that plaintiffs only retained about 46 percent of every dollar spent to compensate them for their injuries. What can reasonably be done at the federal level to solve this malfunction in our justice system? What kinds of measures are more appropriately left to the states?

A: There is little dispute with the ideal of achieving a tort system which will compensate victims both fairly and efficiently. An efficient system will expend the minimum necessary in transaction costs to produce the greatest proportion of compensation to the victims. Unfortunately, at this point, we have little or no benchmark for what the ratio of costs to compensation would be in such an optimally efficient system. We therefore do not know whether a return to victims of 46% is good or bad, efficient or inefficient, and the director of the Institute for Civil Justice (ICJ) and the authors of the study you cite acknowledge just this point. Similarly, we do not know whether this ratio compares favorably or unfavorably to similar ratios in other kinds of cases, such as contract actions.

Finally, we don't know how the ratio based on our current system would compare to those for any alternatives proposed. While various forms of alternative dispute resolution (ADR), for example, are often suggested, any such mechanism must be carefully crafted to avoid depriving litigants of their rights to due process. The benefits of a well-designed ADR system may go beyond mere cost-saving. However, to the extent that ADR is proposed as the solution to a cost problem, it is important to recognize that there is no guarantee that any particular ADR system will necessarily be less expensive than the system it replaces or supplements, and that the risk of inadvertently increasing the total costs of the system by adding layers of process is not insignificant.

It is also important to examine how a ratio like the ICJ's is derived. The ICJ study includes as a cost of obtaining compensation not only the plaintiff's legal fees, but the defendant's legal fees, the insurer's claim processing costs, the value of both the plaintiff's and defendant's time expended, and the cost of the court system. If cost estimates are defined to include costs to society as a whole, benefits should similarly be defined broadly, to include benefits to society beyond the dollar value of the compensation paid to plaintiffs. For example, the benefits of avoiding the costs of similar injuries to other potential victims due to the deterrent effect of successful litigation, or of avoiding the costs to society of injuries gone uncompensated (for example, Medicaid expenditures), may be important to factor in. If the benefit side of the equation is limited to the dollars paid to the successful plaintiff, it may be more appropriate to weigh this only against the costs actually incurred by the plaintiff to determine the fairness of the ratio. I do not mean to suggest that the information in the ICJ report is not useful as it is presented, but only that it may be premature to conclude from this information alone that there is a "malfunction" in our justice system.

If, however, it is decided that changes are in order in the current system for compensating victims of injury, I strongly recommend that states be allowed to analyze their own idiosyncratic problem areas and to experiment with local solutions. This seems to me to be a classic opportunity for experimentation and well-focused problem solving at the state level. Of course, to the extent that problems are seen in the federal court system, federal solutions should be considered as well. Still, I believe that we should be very hesitant to modify, even in the federal system, areas such as product liability, which are governed largely by state substantive law.

The **CHAIRMAN**. I am impressed by the testimony of all three of you. Thank you very much.

Mr. **TEITZ**. Thank you.

Senator **METZENBAUM**. Thank you very much, gentlemen.

Senator **HEFLIN**. I would like to ask a couple more questions.

Senator **METZENBAUM**. Oh, I am very sorry, Senator Heflin; I did not mean to cut you off.

Senator **HEFLIN**. Senator Metzenbaum, General Brown, asked you about the changes in the legislature. I am not familiar with what changes took place, but those changes in the legislature would not have any effect in the Federal suit pertaining to a boycott, would they?

Mr. **BROWN**. They would not.

Senator **HEFLIN**. Now, I have heard a great deal of the testimony and there is no question that it is abhorrent that companies can boycott. Things of this sort shock one's consciousness. Sometimes you wonder if a few bad apples can ruin a barrel, and if there are more than just a few bad apples.

You mentioned the resources. Are you familiar with the Hart-Scott-Rodino Act of 1976?

Mr. **BROWN**. Yes, I am, Senator Heflin.

Senator **HEFLIN**. Does that not provide you with resources by which a State attorney general can pursue antitrust suits for boycotts adequately?

Mr. **BROWN**. Yes, it does provide us with the legal authority to be in Federal court.

Senator **HEFLIN**. Well, it does provide that. Of course, you have the issue of direct purchases and indirect purchases, but if your health care facilities were removed from State level jurisdiction, you would be able to use the Hart-Scott-Rodino Act to pursue an antitrust violation of a boycott, giving you outside counsel in a lot of different ways which provides a lot of resources if they are successful.

I would assume that many lawyers might be interested in pursuing that. I wonder whether the instances of boycott, the instances of intimidation and perhaps coercion in this field—which still have Federal remedies under the antitrust act—are not what we are basically complaining about relative to the insurance industry today.

The question may not necessarily be a change in the law, but a question of enforcement, of bringing the suits and taking action by the Justice Department and by the attorneys general of the various States.

Mr. **BROWN**. Senator Heflin, I agree that when there is boycott, the remedy is there now. Although I do not think the FTC can do anything about it, the Justice Department can.

But that is just one weapon in the arsenal and that is just one scenario. For example, if the companies can continue to get their 200 or 300-percent rate increases, they will not be boycotting. You have to be able to go after price-fixing as well as boycotting. Otherwise, the rates continue to be fixed in a way in which there is no boycott.

I mean, the boycott is kind of the last step where if they do not get the rate increase or laws they want, they pull out, as they did in West Virginia. But most States are simply experiencing massive rate increases, and I think the ability to go after price-fixing is also not only important in any antitrust enforcement, but is extremely important in insurance where rates have been doubling and tripling in various lines of insurance.

Mr. **Shannon**. Senator, if I might add to that, there are whole classes of activities that the insurance companies are engaging in that do not rise to the level of boycott or intimidation or coercion.

We are investigating in Massachusetts, for instance, tying arrangements in insurance companies where, in order to buy one line of insurance, you have to agree to buy another line from the same company.

What we have found startling, frankly——

Senator **Heflin**. Would that not be intimidation?

Mr. **Shannon**. It might be intimidation or it might not, but the point is we have an industry that feels that in order to take any effective action against them, you have to have a case that rises to that level.

What that means is you have an industry that feels that it has immunity; that the threat really is not that great if they engage in these non-competitive kinds of activities. Now, we are not going to solve many antitrust problems merely through litigation, but we can solve a lot of them through the threat of litigation.

This industry does not feel at all threatened by current antitrust regulation and we have got to change that or else the consumers are going to continue to be treated the way they have been over the last several years, by the industry.

Mr. **Teitz**. If I might add something to your question, Senator, I think it is very important to keep in mind that while the wholesale withdrawal of an industry from the market may be one of the most egregious examples of an antitrust violation that we can focus on, you have to consider the impact on a community and a State when we have tremendous price increases that could result from price-fixing, when we have allocation of markets amongst insurance companies that give the purchasing public very little choice, when we have agreements amongst insurance companies only to write policies that have certain terms and pre-conditions that very much impinge upon the rights of the policyholders.

All of those activities clearly would be criminal in any other industry and are clearly not violations of the criminal law for the insurance industry only because of the operation of McCarran-Ferguson.

While we can attempt to push the boycott provision and expand it case by case, there is, in my opinion, tremendously strong circumstantial evidence that can be laid out that insurance companies are engaging in those other types of activities like price-fixing, like market allocation, like uniform policy drafting that have very serious consequences for the consumer and clearly are exempted by McCarran-Ferguson from the operation of the antitrust laws.

So this problem clearly needs, in our opinion, a legislative solution and not just more litigation on the meaning of the boycott provision.

Senator **Metzenbaum**. I want to thank the panel for their cooperation and their testimony. It has been excellent and very helpful to us.

Mr. TEITZ. Thank you very much.

Senator METZENBAUM. If I do not move on to the next panel, I will be here until 8 o'clock tonight still hearing testimony. Our next panel is Edward Muhl, president of the National Association of Insurance Commissioners and Commissioner of Insurance for Maryland; David Levinson, commissioner of Insurance for Delaware; and Donald Halperin, New York State Senator, speaking on behalf of the Conference of Insurance Legislators.

Mr. Muhl, we would be happy to hear from you, sir. I think you know the committee rule with respect to 5 minutes for the testimony.

The CHAIRMAN. Mr. Chairman?

Senator METZENBAUM. Yes?

The CHAIRMAN. Before the panel begins, may I make a brief comment?

Senator METZENBAUM. Surely.

The CHAIRMAN. We are marking up the Contra aid bill in the Foreign Relations Committee. I want the panel to understand that if I get up and leave here, it is not out of lack of interest, but it is because there is a quorum required to mark up the Contra aid bill upstairs on the 4th floor.

I may be going up and down, but it will not be because of my lack of interest here.

Senator METZENBAUM. I appreciate that, and we are happy to have you back if you can make it, but we understand the need to be at the hearing on a mark-up as well.

Mr. Muhl, we are happy to hear from you first, sir.

STATEMENT OF A PANEL CONSISTING OF EDWARD MUHL, INSURANCE COMMISSIONER, STATE OF MARYLAND, AND PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, ACCOMPANIED BY JOHN WASHBURN, DIRECTOR OF INSURANCE, STATE OF ILLINOIS; DAVID N. LEVINSON, INSURANCE COMMISSIONER, STATE OF DELAWARE; AND DONALD HALPERIN, SENATOR, STATE OF NEW YORK, ON BEHALF OF THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS

Mr. MUHL. Thank you, Mr. Chairman, and I would ask that you bear with me as I talk to you through a head cold.

Mr. Chairman, my name is Edward Muhl. I am the Insurance Commissioner in the State of Maryland and President of the National Association of Insurance Commissioners. With me today is John Washburn, Director of Insurance for the State of Illinois, and Vice President of the national association.

We are here representing the NAIC, Mr. Chairman, which is——

Senator METZENBAUM. Mr. Muhl, as you make your testimony, give us a little bit of your own background as to where you came from before you were an insurance commissioner and your own expertise in this field.

Mr. MUHL. I would be more than pleased to.

First, let me suggest to you the NAIC, Mr. Chairman, is a nonprofit organization consisting of all the insurance regulators in the 50 States, the District of Columbia, as well as the four United States territories.

My personal background, Mr. Chairman, I started out working in the insurance industry as an independent claim adjustor back in the 1960s. I worked for Nationwide Insurance Company for a short period of time and then I joined the State of Maryland Automobile Insurance Fund and became their Director of Claims.

The Maryland Auto Insurance Fund basically is a State-run agency that is in the insurance business on the property-casualty side. I had been there approximately 10 years, moved on to the department as the Deputy Insurance Commissioner and then ultimately appointed as Commissioner.

With that, Mr. Chairman, I am sure Director Washburn can give you a little bit of background on himself. But we have also submitted to you some printed testimony which we would respectfully request that you enter that as part of the record.

Senator METZENBAUM. Without objection, the entire statement will be included in the record.

Mr. MUHL. Thank you, Mr. Chairman.

In the few minutes that you have allotted us, let me direct you to several of what we consider many issues that hopefully you will agree suggest that a repeal of the McCarran-Ferguson Act is not warranted and is otherwise unnecessary at this point.

Senate bill 80, as it presently is written, as it presently exists, as it would repeal McCarran-Ferguson, would have two primary results. The first one is that the insurance industry would lose what we consider to be a limited Federal antitrust exemption.

But the second result would be that the States would be in the position of having to relinquish the regulatory oversight as well as the taxation, possibly, of this industry.

Senator METZENBAUM. Why is that?

Mr. MUHL. Because the States under McCarran-Ferguson were left the regulation and the taxation under specific portions of McCarran-Ferguson. A total repeal, as is suggested by Senate bill 80, would put the States in a position of relinquishing that oversight and that control.

Senator METZENBAUM. If that language is left giving States that right, what would your position then be?

Mr. MUHL. That would be much more preferable. I still have personally, and on behalf of the organization, some concerns remaining, as we have outlined in our testimony, with reference to the repeal of the antitrust provisions.

I think it was alluded to very aptly this morning by Mr. Rule, who was on your first panel, who did indicate that a repeal of the antitrust provisions may well, with reference to the State action doctrine, cause less competition, or actually more regulation, and will sort of put us a step back instead of a step forward in the competition aspect in regulation of the insurance industry, and that would be very unfortunate.

It would also give certain exemptions that do not now exist under McCarran-Ferguson with reference to the State action doctrine to the insurance industry. So I personally, as well as on behalf of the organization, have some difficulty along those lines.

But, Senator Metzenbaum, you mentioned just earlier in your opening remarks that you are concerned about the competition, that it does not exist. Well, if one of the purposes and one of the reasons that you want to repeal McCarran-Ferguson is to generate the activity, generate additional competition, I respectfully disagree with your thoughts, in that competition does exist in the marketplace today with reference to the insurance industry.

You have the GAO, who has in several of their most recent publications alluded to the fact that competition exists in various aspects of the insurance industry. You even have some of the critics of both State regulation as well as the insurance industry suggesting that competition was probably the cause—I disagree with this, but the cause of the most recent crisis because there was too much competition; the companies competed themselves into the ground.

We presently have, in my opinion, competition. It does exist; it is real; it is a fact and competition is there. I would refer you and the committee members to page 15 of our written testimony where we have outlined in detail the effects of the repeal of McCarran-Ferguson, and I would urge you and the committee members to review that information and seriously consider the problems that we have outlined.

Now, one of those concerns specifically, as I mentioned earlier, was with reference to the State action doctrine and whether or not by eliminating the limited McCarran-Ferguson exemption that you, in reality, are expanding certain immunities to the insurance industry more than now presently exist.

But let us take it one step further.

Senator **Metzenbaum**. Mr. Muhl, I have to point out to you the light has been on for a couple of minutes, which means your time has expired.

The **Chairman**. Because you have been asking him questions, Mr. Chairman.

Mr. **Muhl**. I apologize, Mr. Chairman. I can then ask, if you would—I have several other——

Senator **Metzenbaum**. You can just take a minute to sum up.

Mr. **Muhl**. Thank you.

I suggest to you that State regulation—I guess equally important is that State regulation is alive and well. We have handled this crisis; we have been through the process. We have handled thousands and thousands of consumer complaints.

We have reviewed the companies for solvency and insolvency; we review their rates. We helped the consumers in over 700,000-some-odd complaints that we have successfully handled throughout the departments.

We are in a position where when we review for solvency and compliance, we have more financial examiners, for an example, than the FDIC has, and there have been a lot less insurance failures than there have been banking failures.

We feel that we have been adequate to the task. We feel that we have been in a position to control the insurance industry, to hold them accountable and protect the interests of the citizens.

I would like to go further, but I will relinquish this time at present. I appreciate the opportunity, Mr. Metzenbaum, and other items and other statements are contained within the written text and I appreciate the opportunity to speak.

[Prepared statement follows:]

TESTIMONY
OF THE
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

I. INTRODUCTION

Mr. Chairman, I am Edward Muhl, Insurance Commissioner for the State of Maryland and President of the National Association of Insurance Commissioners (NAIC). With me is John Washburn, Director of Insurance for the State of Illinois and Vice President of the NAIC and Chairman of the Executive Committee. We represent the NAIC, a non-profit, unincorporated organization consisting of the chief regulatory officials of the 50 states, the District of Columbia, American Samoa, Guam, Puerto Rico and the Virgin Islands. The issue before you today is Senate Bill 80 to repeal the McCarran-Ferguson Act (McCarran).

The statement issued by Chairman Metzenbaum characterizes Senate Bill 80 as primarily a measure seeking repeal of an antitrust immunity statute. This characterization overlooks the express language of Section 2(a) of McCarran, which is:

> The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business.

By adoption of McCarran, Congress concluded that the public would be better served if regulatory authority over the business of insurance were vested in the individual states. Total repeal of McCarran as proposed by Senate Bill 80 is inherently linked with the fundamental issue of state versus federal regulation of insurance. To suggest that state regulation of insurance will not be impacted by repeal is to ignore the significance of the regulatory vacuum and the uncertainty that would be created.

II. STATE REGULATION OF INSURANCE

Leaving aside issues relating to the federalism, the NAIC perceives several fundamental reasons why state regulation of insurance should be preserved. There is in place an existing system of regulation that has been serving the insurance buying public well for many years. The state insurance departments utilize over 50 offices, employ over 6,400 persons and expend combined budgets in excess of $267,000,000 to regulate the business of insurance. As a general proposition, it is more efficient and less expensive to revise or change existing institutions than to create a new institution.

A. FINANCIAL CONDITION

To illustrate this premise it is useful to explain the pervasive state regulatory mechanism in place to regulate the financial condition of the approximate 5,000 insurers operating in the United States. Insurance regulators monitor financial condition through capital and surplus requirements, investment prohibitions, analysis of annual statements, periodic examinations, CPA audits, statutory accounting principles and application of diagnostic tests to insurer data. About 1,300 examiners are employed by the insurance departments to conduct periodic field examinations of insurers. The majority of these examiners hold a Chartered Financial Examiner (CFE) or Accredited Financial Examiner (AFE) designation which is awarded by the Society of Financial Examiners after training and testing. This year the NAIC purchased an automated data processing program which will allow field examiners to directly access an insurer's data base thus improving the quality and credibility of examinations.

In addition to field and desk audits of financial examination data, the NAIC employs the Insurance Regulatory Information System (IRIS) to assist the states in identifying financially troubled companies. A series of tests or ratios measuring profitability, liquidity, reserves, and premium to surplus are applied to insurers' annual statement data. If a company falls outside the accepted range of values, the domiciliary state and the other states in which the insurer is licensed are notified of the results so that appropriate corrective action can be initiated. States are immediately notified of IRIS results over the State Telecommunications Network which links the states via an interactive on-line data base.

The regulation of financial condition is premised on cooperation among the states. For instance, for those insurers that do business on an interstate basis and are licensed in more than one jurisdiction, a zone or "association" examination is called by the domiciliary state. The examination is conducted pursuant to the uniform procedures and reporting requirements established by the NAIC Examiners Handbook. Through the NAIC offices, other states in which the insurer is licensed are invited to participate in the examination and therefore coordination of available expertise and avoidance of duplicate examinations is achieved.

B. MARKET CONDUCT

Market conduct surveillance is another state regulatory mechanism used to evaluate insurers' compliance with statutes and regulations relating to the insurers' market practices and their dealings with policyholders and claimants. The states conduct examinations similar in nature to the financial examinations discussed above, either on-site or in the state department. The four key market conduct areas are: (1) sales and advertising, (2) underwriting, (3) rating, and (4) claims. Examination of these areas enable the states to detect possible violations of unfair trade practice acts and other statutes and regulations as expeditiously as possible. In examining an insurer's market practices, the states utilize information from the various divisions within the insurance department concerning financial information, complaints, rating and policy forms, and agents and brokers. Market conduct examiners and financial examiners generally coordinate information to assist each other in discovering financial or market conduct problems. Market conduct activities are coordinated among the states as well as within the departments. The end result of a market conduct examination is a determination of whether any violations have occurred and whether corrective action is necessary.

This overview of financial surveillance and market conduct illustrates the extensive regulatory mechanisms which are in place. These tools are constantly under review and revision by state regulators and the NAIC to respond to a dynamic marketplace. A similar analysis of guaranty fund mechanisms, holding company regulations and agency and company licensing could be recited to illustrate the regulatory activity operational in the states.

Furthermore, there is no evidence that the quality of federal regulation would justify the expense and dislocation incident to a shift in regulatory responsibility - the history of some federal agencies substantiates this concern. Recent news reports have revealed concerns with federal regulation of the banking industry. The FDIC Chairman was quoted in a recent Wall Street Journal as stating that a portion of the bank examiners had been on the job for less than 18 months.

Although the NAIC cannot predict with any certainty the dislocation that would result from repeal, we can anticipate interest from the Federal Trade Commission, Department of Commerce, Securities and Exchange Commission, Department of Health and Human Services and Department of Justice. It can be anticipated that these agencies and others would become involved in insurance regulation. This disproves the notion that federal regulation would necessarily assure uniformity, assuming uniformity is a goal, and further makes the case for preserving the existing state structures.

C. INDIVIDUAL AND COOPERATIVE STATE EFFORTS

Diversity and experimentation are possible with individual state insurance departments. Marketplace conditions may differ substantially from state to state. A state regulator may react more promptly to local conditions than a federal regulator bound to national constraints. The dispersion of power tends to restrict the impact of mistakes to a limited segment of the business whereas an effective innovation by a particular state is apt to be adopted elsewhere after a period of time and testing. This is a unique characteristic of state regulation.

An often expressed notion is that state regulation should stand or fall according to the quality of the weakest state. A more meaningful axiom might be that state regulation is as strong as its strongest state. Insurers writing a significant amount of business are licensed to do business in several states, each of which exercises regulatory control. As a result, if the regulation in several states is effective, virtually all of the business is subject to that regulation. In practical effect, the stronger states do much to assist states with more limited resources.

Additionally, through the auspices of the NAIC, the states freely share personnel and technical expertise with other states. Through the committees and task forces of the NAIC, innovative regulatory approaches are brought to the attention of other states and often modified or revised to meet the individual needs of a particular jurisdiction.

D. CONSUMER ASSISTANCE

Although a tired statement, state insurance departments are close to the insurance buying public. It is a relatively simple process for an individual consumer to call his local insurance department or to visit the insurance department office personally to obtain answers to his inquiries or to seek assistance with handling of a claim. Direct access to the insurance commissioner or senior department staff is a real possibility in many states. Some jurisdictions maintain tole-free consumer hotlines to handle consumer complaints. Others have established consumer bureaus throughout the state. Upon receipt of a complaint, an insurance department conducts an investigation. The commissioner determines whether additional corrective action is necessary and/or whether a sanction is appropriate. The consumer is then notified of the final disposition of the complaint. Over 735,000 consumer complaints were handled by insurance departments in 1985. Although nationwide data is not available, the Nevada Commissioner reported that his department assisted in the return of $2.4 million to consumers in his state last year.

E. ACCOUNTABILITY

A significant although unusual check and balance occurs with respect to state regulation due to the accountability of state regulators to not only state executive and legislative branches, but to the Congress through periodic hearings such as this hearing today and the continuous review by the General Accounting Office and the Federal Trade Commission at the request of Congress.

The case for state regulation is a strong one. The system exists and, although not perfect, is subject to constant review and revision by internal and external forces. The state system is capable of experimentation, change and vitality. It is close to and more responsive to the people, and more importantly we believe state regulation is achieving its goals.

II. MCCARRAN-FERGUSON ACT

McCarran is significant in two critical respects. It authorizes the states to regulate the insurance industry as discussed above, and it provides a limited immunity from the federal antitrust laws for certain insurer activity.

The enactment of McCarran occurred in response to a landmark decision issued by the United States Supreme Court in South-Eastern Underwriters Association v. United States. The case originated from a Department of Justice investigation into the affairs of the Association, its 198 member companies, and 27 of its officers, alleging violations of the Sherman Antitrust Act. The court in South-Eastern Underwriters held that insurance was interstate commerce, meaning that the industry was subject to federal regulation.

In response to the South-Eastern Underwriters decision, Congress recognized the need for state authorization to regulate the industry and to collect premium tax. In addition, Congress recognized the propriety of allowing the states to regulate the competitive nature of the industry. Therefore, McCarran provided the insurance industry with an exemption from federal antitrust laws. The exemption is a limited one, which comes into play if (1) the activity at issue constitutes the business of insurance, (2) the activity is regulated by state law, and (3) the activity does not amount to boycott, coercion or intimidation. At the outset, therefore, the exemption from antitrust scrutiny is limited, and it is further restricted by caselaw which has developed over the years. As an example, the courts have narrowly construed the meaning of the "business of insurance." Therefore, the exemption is not as broad as some represent it to be.

Those who advocate repeal of McCarran argue that the development of the judicially-created "state action" doctrine will protect the insurance activities from application of the federal antitrust laws. The NAIC suggests, however, that recent developments regarding the application of the state action doctrine place this alleged protection under question.

III. NAIC'S INVOLVEMENT IN THE RELATIONSHIP BETWEEN COMPETITION AND RATE REGULATION

The relationship between competition and rate regulation in the property and liability insurance industry traces back to private efforts to control rates, the anti-compact laws, and the early rating laws. The NAIC became involved in the area of regulating insurance rates after the enactment of the McCarran. In the early 1900's the NAIC and the All Industry Committee drafted a model rating law which was a prior approval approach to rate regulation. This rating law was the basis for the states' adoption of fire and casualty rating laws. By the mid-1900's, the pricing practices of the property and liability insurance business were regulated on a nationwide basis.

The enactment of the model rate regulatory laws was basically an anti-competitive approach to regulation. During the late 1950's the attitude concerning competition began to change, in part because of the efforts of rating organizations and their member companies and because of the allowance of deviations from established rates. In addition, a Congressional subcommittee conducted an extensive study on antitrust laws and the insurance business. This study led to recommendations to further remove impediments to competition. The recommended changes in the model laws were adopted in 1962.

The activity of this subcommittee instigated a series of initiatives by the NAIC which led to a more competitively oriented rate regulatory environment. The NAIC conducted an extensive review of insurance rates in 1964 and adopted a landmark report in 1968 recognizing the market changes in the property and liability business, particularly with respect to the competitive setting in the demise of bureau domination. The report advocated response to the current market conditions and reliance on open competition to produce and maintain reasonable and competitive prices where such competition exists. The recommendations therefore included suspending prior approval in states in which an increase in competition had occurred. The report reaffirmed the NAIC's belief in the importance of competition in rate regulation, but made it clear that the NAIC would continue to support other forms of rate regulation where competition would be inadequate and/or where the current system was functioning well.

In 1974, the NAIC staff published a comprehensive two-volume study on competition and rate regulation. Thereafter a subcommittee worked on developing an ongoing system to monitor competition. The subcommittee's work culminated in the NAIC's adoption of the Property and Liability Model Alternative Competitive Pricing and Appropriate Support Systems Act. The premise underlying the model is to foster competition while achieving other fundamental public policy goals.

The NAIC has responded to the changing marketplace by adjusting its position on how to regulate insurance rating activities. Its prior approval approach has been gradually transformed into an open competition method of regulating rates, tempered with a recognition of public policy concerns such as availability, fairness, and equity.

IV. ANTITRUST IMMUNITY

Section 2(b) of McCarran sets forth the antitrust immunity:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided That after January 1, 1948,* the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

*Act of July 25, 1947 substituted "June 30, 1948" for "January 1, 1948."

The Sherman Act prohibits contracts, combinations, or conspiracies in restraint of trade, and also proscribes monopolies. The Clayton Act, enacted after the Sherman Act, was intended as a supplement to prohibit specific practices such as price discrimination, tying arrangements, and exclusive dealing arrangements. The Act was designed to reach anti-competitive activities at the outset. The Federal Trade Commission (FTC) Act provides that unfair methods of competition and unfair or deceptive sets or practices in commerce are unlawful. The FTC Act established a regulatory agency to supplement judicial enforcement. Another principal federal antitrust law is the Robinson-Patman Act, actually an amendment to the Clayton Act, which prohibits specific discriminatory practices. Application of these four antitrust laws is precluded under McCarran. Without the McCarran immunity, these laws would be applied if the activities involve interstate commerce.

In implementing McCarran, Congress recognized the importance of granting this limited immunity. McCarran does not, however, authorize complete immunity from antitrust. Complete immunity was advocated in the original House bill, but was defeated. The immunity is limited in several ways. First, it is limited by the Act's requirement that state regulation must exist in order to trigger the immunity. Second, the Act leaves boycott, coercion, and intimidation to federal antitrust enforcement. Finally, the development of the state action doctrine has actually limited the reach of McCarran immunity.

Despite the existence of McCarran, other federal laws, non-antitrust, operate to control anticompetitive behavior. The Commerce Clause, the First Amendment, the Due Process Clause, and the Civil Rights Act are all vehicles for controlling anticompetitive activities. All of these examples illustrate that McCarran immunity is not blanket protection from federal antitrust laws.

V. REPEAL OF MCCARRAN - ITS EFFECT

A. STATE ACTION DOCTRINE

The extent to which total repeal of McCarran would eliminate its two fundamental features, state regulatory authority and antitrust immunity, creates some uncertainty. Repeal of McCarran in its entirety would eliminate the "business of insurance" immunity from federal antitrust laws.

Therefore, the federal antitrust laws would apply to the insurance industry, along with the judicial developments, interpretations, and exceptions. One of the principal exceptions to the federal antitrust laws is the "state action" doctrine which will exempt some of the industry's activity from scrutiny if McCarran is repealed. The impact of repeal extends not only to antitrust, but to interstate commerce challenges. Allegations that state activity burdens interstate commerce may result in preemption under the Supremacy Clause of the United States Constitution.

The state action doctrine emerged in Parker v. Brown, a 1943 Supreme Court decision which originated from an alleged Sherman Act violation. The Court held that the Sherman Act was not intended to apply to state action. The meaning of "state action" has been in controversy since that decision and is still unresolved today. The test which evolved is that immunity from federal laws exists if the state has expressed a clearly articulated intention to regulate and has actively supervised the activity at issue.

One of the most critical effects that the courts will have on state regulation is their interpretation of what constitutes "active state supervision" for purposes of triggering the state action doctrine. It can be reasonably anticipated that extensive and expensive litigation will ensue as state statutory mechanisms are subjected to the "state action" test.

Much depends on judge-made law. Although some uncertainty accompanies the judicial construction of the McCarran immunity, the absence of McCarran may create even more uncertainty with respect to the exemptions on which the industry would rely. The amount of antitrust litigation involving the industry probably would increase. Insurance commissioners may be less certain than they can be today about the extent to which they share regulatory jurisdiction with the United States Department of Justice, the Federal Trade Commission, and private treble damage plaintiffs.

A recent FTC administrative decision involving five title insurance companies restricts the test previously set forth for triggering the state action doctrine. The judge's interpretation of the second prong of the test, "active state supervision," is a "determination as to whether there was, in fact, a review, monitoring, and an examination of critical aspects of the ratemaking process." The judge defined agent commissions as a critical aspect of the process which should have been examined by the state agency. Because the evidence in the case did not substantiate this actual examination of agent commissions, the second prong of the state action test was not met according to the judge. Therefore, federal antitrust scrutiny applied to the activity.

The judge's interpretation of "active state supervision" requires an inquiry into previous agency review. This places a retroactive burden on the agency to substantiate the examination of certain aspects of the ratemaking process which are determined by a court at a later point in time to be critical. The FTC decision identifies only one aspect of ratemaking which the judge considered critical. The judge's decision is currently on appeal to the full Trade Commission, but its ramifications should be considered in analyzing the effects of repealing McCarran.

B. ACTIVITIES SUBJECT TO ANTITRUST LAWS AFTER REPEAL OF MCCARRAN

The states' authority to regulate the industry dissipates if McCarran is repealed. All regulatory activities from licensing to monitoring solvency may be subject to federal scrutiny, depending on the courts' view of whether the states are "actively supervising." Beyond that, if the state action doctrine is held not to apply, federal preemption may occur.

Repeal of the exemption would have the greatest impact on ratemaking activities, particularly on ratemaking in states with rating laws which provide relatively limited statutory authority to supervise ratemaking. Such states are principally those with "open competition" rating laws of the "use and file" or "no file" types. Ratemaking activity in those states is probably protected now from antitrust exposure by the McCarran exemption. However, in the absence of the McCarran exemption, joint ratemaking activity in such states may be exposed to antitrust sanctions; the other exemptions generally available under the antitrust laws probably would not provide protection.

The effects of repeal of the exemption on insurance activities other than ratemaking, and on ratemaking in "prior approval" and "mandated rates" states, is more problematic. The exemption has never protected some matters involving insurance companies, and is being narrowed by judicial construction. Even if repeal occurs, other exemptions applicable generally under the antitrust laws (principally the exemption for state action) probably would exempt much of the conduct now exempted by McCarran.

The activities which may be subject to federal antitrust scrutiny include:

1. **Pooling of information**
2. **Standardization of policy forms and classification of risks**
3. **Pooling of risks**
4. **Residual market mechanisms**
5. **Tying arrangements**
6. **Mergers**

1. POOLING OF INFORMATION

Pooling of information, or the sharing of statistical data, is an essential rating activity which may be subject to federal antitrust scrutiny in the event McCarran is repealed. The pricing of insurance products is unlike any other. The cost of an insurance product must be estimated at the time of sale, contrary to the way in which other products are priced. Other products are priced before sale with the knowledge of costs of manufacture and delivery. The final cost of an insurance product is known when the losses, if any, have been incurred and paid. Therefore, the price of an insurance product is based on an expectation of future experience which has been calculated from various statistical sources. The existence and practices of rating organizations are inherently contrary to the antitrust concept. Although the courts have approved of exchanging historical cost data, the decisions are strictly limited to the exchange of data and unquestionably scrutinize activity relating to price. Existing caselaw does not guarantee protection for the sharing of statistical data on pricing.

2. STANDARDIZATION OF POLICY FORMS AND THE CLASSIFICATION OF RISKS

The standardization of policy forms and the classification of risk activities are likely to stabilize the cost of purchasing policies. Therefore, under the holdings discussed above in Section 1, these activities may be curtailed.

3. POOLING OF RISKS

An insurance pool is an association of insurers which share premiums and distribute losses among the members for a certain risk(s). Pools may be quite sophisticated in that they may hire staff to underwrite, inspect risks and service claims. On the other hand, many small pools exist and operate with limited staffing. The basic functions of a pool are:

> (1) To afford a market for insureds seeking extraordinarily large amounts of insurance to be provided in a single policy. Member companies may be unwilling or unable to provide such coverage individually;
>
> (2) To afford a market for classes of insureds whose operations are such as to require special service facilities not ordinarily furnished by many individual insurers;
>
> (3) To afford a market for insureds whose operations present an exceptionally great hazard, especially in instances in which there are relatively few insureds engaged in such operation;
>
> (4) To afford a market for insureds whose insurance is not acceptable to the individual insurers which comprise the pool;
>
> (5) To afford a medium for insuring special classes of insureds at rates and under rating procedures which differ from those used by the individual company members;
>
> (6) To afford small companies a means of competing with large ones by making available to each pool member the combined capacities of the group.

Examples of pools include the American Nuclear Insurers, the Mutual Atomic Energy Liability Underwriters and the MAERP Reinsurance Association pools which provide coverage against nuclear losses. Together these pools make available to any nuclear facility liability coverage which provides financial protection for the general public. Also, insurance is provided to cover damage to the nuclear facility.

Another example is the American Hull Syndicate pool which provides ocean marine insurance, principally hull coverage for ship owners.

The United States Aircraft Insurance Group and the Association Aviation Underwriters pools are two of the principal markets in this country for aviation insurance, especially for commercial aircraft.

The above are illustrations of direct writing pools which permit a variety of commercial and industrial activity. In addition, there are a variety of reinsurance pools which support direct writing companies. Finally, there is joint underwriting, a less formal method of coordinating activities of insurers to distribute risks among a number of insurers for policyholders, usually businesses, with large risk exposure.

At this point it is only speculation that the pooling activities listed above will survive federal antitrust challenges.

4. RESIDUAL MARKET MECHANISMS

Unlike the sale of other products, insurance requires a selection of customers. This selection, or underwriting, process distinguishes insurance from other products. Selective underwriting causes the reduction of options for some persons and precludes others from obtaining coverage. Pursuant to state laws, the obtaining of insurance is compulsory in some areas such as auto insurance. Therefore, the state assigned risk plans are one type of response designed to minimize the impact of selective underwriting. State plans such as the assigned risk plan run contrary to antitrust concepts because they specifically set out the coverage, premium, commission and form of the policy. However, without the assigned risk plans, availability is a distinct problem for some consumers who must comply with the laws on mandatory coverage.

Workers compensation insurance, an example of statutorily mandated coverage, is another residual market mechanism which may be scrutinized in the event McCarran is repealed.

FAIR plans for property insurance and plans for medical malpractice are also considered residual market mechanisms. In administering the programs, insurers act in concert to develop rates and forms. Without the protection of McCarran, these activities are subject to antitrust scrutiny as per se violations in that they are concerted efforts to fix prices and they allocate or divide markets. FAIR plans are directed at making property coverage available in the inner cities when it is not otherwise available to an individual, family or business in the voluntary market. The medical malpractice plans, which are also state compelled mechanisms, assure availability of insurance for malpractice. The absence of such coverage has lessened the quantity and quality of health care service because some health care provider groups have refused to practice or have restricted their practices.

Other residual market mechanisms which have effectively assisted consumers in dealing with the recent availability problems include state authorization for the formation of joint underwriting associations (JUA's) and the development of market assistance programs (MAP's). Joint underwriting associations are comprised of insurers which join together in accepting risks otherwise difficult to insure. Market assistance programs are formulated by insurance regulators to maximize access to existing liability insurer markets.

The role that these residual market mechanisms play in availability of coverage cannot be overemphasized. The applicability of the state action doctrine may supply some protection for these activities, but the amount of protection depends on whether the state has clearly articulated an intention to regulate and is actively supervising the activity in question.

5. TYING ARRANGEMENTS

A tying arrangement is prohibited under the Sherman and

Clayton Acts. A tying arrangement is the conditioning of the sale of a product on the purchase of another product. Tying arrangements are examined pursuant to the Sherman Act since the Clayton Act limits its application to goods other than insurance. Under McCarran if the activity is the business of insurance, it is immune. In other words, if the arrangement forces a customer to purchase insurance as a part of the deal, it is probably immune from antitrust challenges. Many tying arrangements are not considered harmful and are even necessary in providing coverage in certain circumstances. Without McCarran, all tying arrangements may be targeted by the federal antitrust laws.

6. MERGERS/ACQUISITIONS

The merger and acquisition of insurance companies are currently regulated in many states by holding company acts. These acts require an extensive filing, a public hearing before the insurance commissioner, and departmental approval prior to merger. Currently, the federal antitrust laws are applied to mergers only when the state does not regulate. The repeal of McCarran may expose these transactions to the scrutiny of federal antitrust laws.

The dependence on the courts for immunity in each of the above listed areas of activity is a significant variable. Case-by-case resolution of antitrust application will be a cumbersome process to endure in hopes of gaining increased competition, which will be minimal at best. Senator Metzenbaum refers to the prolonged litigation in the FTC title case as undesirable. Adoption of a pure antitrust approach is certain to entail more protracted litigation than ever before, especially with respect to establishing some definite guidelines for determining what constitutes "active state supervision." In the FTC title insurance case, the defendants had every right under the law to pursue the immunity for activities which constitute the business of insurance.

VI. OTHER CONSIDERATIONS

A. MINIMAL INCREASE IN COMPETITION DOES NOT JUSTIFY TOTAL REPEAL OF MCCARRAN

Proponents of the antitrust approach desire enhanced competition in the insurance industry. The approach may not necessarily lead to more competition - it may lessen it. The application of antitrust laws to some of the current rating activities such as pooling of statistics and the development of manuals and forms may eliminate benefits which result in cost savings to the consumer. In that respect, the antitrust approach is unsatisfactory. The NAIC believes that the industry is highly competitive. The competitive nature of the industry actually may be the core of the availability crises that the country has experienced. The current liability crisis has not resulted from anti-competitive activity such as concerted refusal to deal or desire to restrain trade. It is the extremely competitive nature of the industry which prompted the underpricing of products, followed by efforts to recoup losses by drastically increasing premiums.

B. FTC AUTHORITY MAY BE EXTENDED

Section 5 of the FTC Act prohibits unfair methods of competition and unfair or deceptive acts or practices. State insurance regulatory schemes contain similar prohibitions. If McCarran is repealed, it creates a question of whether FTC activity preempts state insurance regulatory activity. The FTC has broad administrative and rulemaking powers. If the FTC finds that a respondent has engaged in unfair trade practices, the Commission's authority extends to issuing a cease and desist order against the activity. If the state laws prohibiting the same activity do not meet the criteria set forth under the state action doctrine, it is presumed that FTC authority could preempt state action under the Supremacy Clause of the U.S. Constitution. Whether preemption would occur is subject to the normal application of the preemption doctrine. As for the FTC's administrative promulgation of rules, legislative history indicates that Congress intended the FTC's rules on unfair or deceptive practices to preempt state law.

The most difficult issue which is unresolved is whether the FTC's authority (adjudicatory and/or substantive rulemaking) would preempt state law or private conduct which constitutes "state action." An examination of the Parker doctrine and subsequent court interpretations of the criteria set forth in that case show that it is unclear whether state action will actually restrict FTC preemptive authority. The FTC, in its report of the State Regulation Task Force of the FTC dated March 14, 1986, stated that the state action doctrine limits "may not restrict the Commission very much" particularly in the consumer protection area.

VII. SUMMARY

Proponents of repeal of McCarran have yet to point out specific examples of the problems which have apparently been created by the antitrust exemption. Senator Metzenbaum states that the exemption prevents the FTC, the Department of Justice, and private plaintiffs from challenging blatant anti-competitive activity. The antitrust exemption is not a blanket immunity. It has never prevented a federal agency from investigating or prosecuting boycott, coercion, or intimidation. The exemption is further limited by the courts' interpretation of what constitutes the business of insurance. The phrase has been narrowly construed. In addition, the state action doctrine limits the applicability of the exemption to the two criteria discussed above.

JUDICIARY COMMITTEE
'87 APR 21 AM 9 18

STATE OF ILLINOIS
DEPARTMENT OF INSURANCE
SPRINGFIELD, ILLINOIS 62767

April 10, 1987

OFFICE OF THE DIRECTOR

Honorable Joseph R. Biden
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Senator Biden:

Please excuse this tardy response to your letter of February 25 concerning questions which you had but did not have an opportunity to pursue at the McCarren-Ferguson hearing on February 18, 1987. Ed Muhl has requested that I reply for both he and I. What follows are responses to your specific questions in the same order that they were presented. In addition, I have attached to this letter a report prepared by this Department which was furnished last year to the Illinois General Assembly and Governor Thompson on the subject of reinsurance to give you further insights into the subject.

1) The ability of an insurer to write high limit property and casualty insurance subject to a catastrophic loss is directly related to the ability of the insurer to purchase excess reinsurance(reinsurance over a specified primary layer). The ability of the insurer to reduce the likelihood of losses is immaterial since as this is not a "working" layer of protection or a level often used. This level of protection protects the unusual happenings. As you know, even fireproof buildings can burn and the most safety conscious manufacturer can accidentally pollute a ground water supply. A reduction in reinsurance capacity is most immediately noticed in the excess reinsurance market which makes it nearly impossible for some insureds to purchase the amount of insurance they would like. When professional reinsurers suffer a reduction in surplus, such as a result of underwriting and operating losses or otherwise as occurred in the early and mid-1980s, thereby reducing their capacity to reinsure, their first reaction is generally to reduce the amount of reinsurance which can be purchased by any one reinsured as opposed to simple elimination of their clients.

This is one of the reasons why professional liability, directors and officers liability and errors and omission liability and pollution liability can seldom be purchased at requested limits. Also, as you have noted, reinsurance capacity has been impacted by insolvencies of certain reinsurance companies; however, these companies where not substantial in comparison to the total reinsurance market. Nevertheless, they have had an impact in certain specialty markets (unusual markets requiring a particular expertise in underwriting and claims management).

2) State regulation does not attempt to regulate non-U.S. reinsurers. Rather the approach has been to prohibit recognition of reinsurance ceded to alien reinsurers unless the company holds collateral assuring payment by the reinsurer. This collateral often takes the form of bank letters of credit which adds cost to the reinsurance transaction. I do not have an answer as to what Congress should do to insure solvency and the availability of reinsurance. Certainly, reinsurers will commit capital to underwriting insurance business when they have the resources to do so and when they feel that the business can be priced accurately. There is no question that the availability of reinsurance has been improving over the last several months. With respect to solvency of reinsurers, it is our feeling that it is the ceding companies responsibility to see that it places reinsurance with financially sound companies. Certainly, secrecy laws and differences in accounting practices and regulatory standards make the task difficult for not only companies but also U.S. insurance regulators.

3)4) Insurance companies often require reinsurance cover in amounts far beyond the ability of a single reinsurance company to provide, in turn reinsurers themselves often retrocede a portion of their exposure (a retrocession is the reinsurance of reinsurance). It is usual for minor participants in a reinsurance treaty to rely on a "lead" reinsurer to develop the appropriate price for the reinsurance provided. It would simply be impossible for every reinsurance participant to make its own independent evaluation of the reinsured exposure and develop its own price. It should be remembered that it is not uncommon for there to be as many as twenty or thirty participants on an individual reinsurance treaty. Were this system of inter-reliance prohibited it would be uneconomic as well as impractical from a time standpoint for reinsurance to be written with multi-participants.

We are not sure how the current practices would be affected by repeal of McCarren-Ferguson. Would this practice be prohibited? In this regard we have heard the same conflicting views as you. The sheer uncertainty will probably cause short term problems and if conflicting interpretations develop these can lead to long term problems. Reinsurance, like other commodities will be sold where the greatest profit can be expected. As other countries become more developed their need insurance increases. This affects how much capacity is available to the U.S. The U.S. is still the largest marketplace in the world. It seems extreme to think that the foreign reinsurers will affect a complete retreat from this marketplace. However, there are lines (types) of insurance that many foreign reinsurers avoid if possible. The number of lines with capacity problems may increase depending on the worldwide demand vis a vie supply. This is not meant to sound like Economics 101 but the principles indeed do apply to this market and there does not appear to be any clear answer to your question.

Again, I apologize for the tardy response and should you have any further questions or need any additional information, I would be pleased to assist.

Very truly yours,

John E. Washburn

John E. Washburn
Director

JW:bs

Att.

IV. THE REINSURANCE MARKET

ILLINOIS DEPARTMENT OF INSURANCE

JOHN E. WASHBURN, DIRECTOR

JAMES W. SCHACHT, CHIEF DEPUTY DIRECTOR

APRIL, 1986

PREFACE

THIS PAPER WAS PREPARED BY THE ILLINOIS DEPARTMENT OF INSURANCE TO REVIEW AND EXPLAIN THE PRESENT REINSURANCE MARKETPLACE IN RESPONSE TO RESOLUTION 831 ADOPTED BY THE HOUSE OF REPRESENTATIVES OF THE STATE OF ILLINOIS DURING THE 84TH GENERAL ASSEMBLY.

JAMES W. SCHACHT, CHIEF DEPUTY DIRECTOR OF THE DEPARTMENT PREPARED THIS PAPER.

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I. INTRODUCTION

PROBLEMS OF INSURANCE AVAILABILITY AND AFFORDABILITY HAVE DEVELOPED IN CONNECTION WITH A NUMBER OF VITAL COMMERCIAL LINES INCLUDING MUNICIPAL LIABILITY, ENVIRONMENTAL POLLUTION, DIRECTORS AND OFFICERS LIABILITY, TRUCKING AND OTHERS. A FACTOR IN THESE PROBLEMS HAS BEEN THE UNAVAILABILITY OF REINSURANCE OR THE INCREASING COSTS OF REINSURANCE.

THE OBJECTIVES OF THIS PAPER ARE TO EXPLAIN WHAT REINSURANCE IS AND HOW IT OPERATES; WHY REINSURANCE COSTS HAVE INCREASED; AND WHY COVERAGE HAS BECOME UNAVAILABLE. THIS PAPER WILL NOT ATTEMPT TO ANSWER ALL QUESTIONS SINCE REINSURANCE BY ITS VERY NATURE IS VERY COMPLEX AND INTERNATIONAL IN SCOPE. ALSO, THE PROBLEMS OF THE PRIMARY INSURANCE MARKETPLACE WILL NOT BE COVERED IN DETAIL SINCE THIS SUBJECT IS BEING ADDRESSED IN A SEPARATE PAPER PREPARED BY THE DEPARTMENT; ALTHOUGH IN MANY RESPECTS, THE PROBLEMS IN THE REINSURANCE MARKETPLACE "MIRROR" THE PROBLEMS IN THE PRIMARY INSURANCE MARKETS.

II. FINANCIAL STATE OF THE REINSURANCE INDUSTRY

WHEN ONE EXAMINES THE FINANCIAL STATE OF THE REINSURANCE INDUSTRY IT MUST BE RECOGNIZED THAT THE REINSURANCE MARKET IS AN INTERNATIONAL ONE. MANY U.S. INSURERS AND REINSURERS PURCHASE REINSURANCE ABROAD. ALSO, ALIEN

REINSURERS CEDE FOREIGN RISKS TO U.S. REINSURERS TO ACHIEVE FURTHER RISK SPREADING. TABLE 1 OF THE APPENDIX PRESENTS DATA COMPILED BY THE U.S. DEPARTMENT OF COMMERCE WHICH SUMMARIZES REINSURANCE TRANSACTIONS OF U.S. COMPANIES WITH INSURERS LOCATED ABROAD FOR THE PERIOD 1978 THROUGH 1984. THIS DATA ILLUSTRATES THAT ON A NET BASIS, THE U.S., WHICH BY FAR IS THE LARGEST INSURANCE MARKET IN THE WORLD, IS AN EXPORTER OF REINSURANCE. THIS FACT IS NOT NEW SINCE IT IS A SITUATION THAT HAS EXISTED FOR MANY YEARS. IN FACT, OF THE TOP 15 OF THE WORLD'S LEADING PROFESSIONAL REINSURERS, ONLY FIVE ARE LOCATED IN THE UNITED STATES. THE LARGEST REINSURER IS LOCATED IN WEST GERMANY AND THE SECOND LARGEST IS LOCATED IN SWITZERLAND.

IN 1984, THE PROPERTY AND CASUALTY INDUSTRY AS A WHOLE SUFFERED ITS WORST YEAR SINCE 1906, THE YEAR OF THE SAN FRANCISCO EARTHQUAKE AND FIRE. INVESTMENT INCOME WAS INSUFFICIENT TO OFFSET UNDERWRITING LOSSES OF $21.7 BILLION RESULTING IN AN OPERATING LOSS OF $4.1 BILLION. THE INDUSTRY LOST OVERALL IN EXCESS OF $18.00 ON EACH $100.00 OF PREMIUM INCOME. THESE OVERALL RESULTS MASK FAR MORE ADVERSE RESULTS IN CERTAIN LINES OF BUSINESS SUCH AS COMMERCIAL GENERAL LIABILITY AND MEDICAL MALPRACTICE. RESULTS FOR THE U.S. REINSURANCE INDUSTRY WERE EVEN MORE BLEAK. IN 1984, THE INDUSTRY EARNED PREMIUM OF APPROXIMATELY $7.2 BILLION. HOWEVER, THE INDUSTRY'S UNDERWRITING LOSSES AND COMMISSION EXPENSES TOTALLED

$9.6 BILLION. THIS MEANS FOR EVERY $100.00 OF PREMIUM, THE REINSURANCE INDUSTRY INCURRED LOSSES AND EXPENSES OF APPROXIMATELY $133.00. THIS OPERATING LOSS RESULTED IN A 7% DECLINE IN POLICYHOLDER SURPLUS FOR THE REINSURANCE INDUSTRY. POLICYHOLDER SURPLUS IS THE FINANCIAL BASE THAT ALLOWS A COMPANY TO SELL INSURANCE, AND PROVIDES ADDITIONAL FINANCIAL PROTECTION TO POLICYHOLDERS IN THE EVENT OF UNFORESEEN LOSSES. THE GREATER A COMPANY'S SURPLUS, THE MORE BUSINESS A COMPANY CAN WRITE. A SHRINKING OF POLICYHOLDER SURPLUS BY DEFINITION MEANS LESS CAPACITY TO WRITE BUSINESS. REGULATORS EITHER BY PRACTICE OR BY LAW LIMIT AN INSURER'S CAPACITY TO WRITE AS A MULTIPLE OF POLICYHOLDER SURPLUS.

THE COMBINED RATIO MENTIONED ABOVE FOR 1984 REFLECTS A FIVE-YEAR WORSENING TREND FOR THE REINSURANCE INDUSTRY AS ILLUSTRATED BY THE FOLLOWING TABLE:

YEAR	COMBINED RATIO*
1980	107
1981	108
1982	114
1983	119
1984	133

*LOSSES AND EXPENSES INCURRED IS A PERCENTAGE OF PREMIUMS EARNED.

IN ADDITION, IN 1984 REINSURERS REFLECTED A RETURN ON NET WORTH OF A -14% WHICH IS NEARLY 12 POINTS BELOW THE INDUSTRY AVERAGE FOR THAT YEAR. SINCE REINSURERS ARE OFTEN INVOLVED IN THE RISKIEST COVERAGES, FINANCIAL AND ECONOMIC THEORY DICTATES THAT THEY SHOULD THEREFORE BE REWARDED WITH LARGER AVERAGE RETURNS OF NET WORTH. THIS HAS NOT OCCURRED SINCE RETURNS ON NET WORTH FOR REINSURERS HAVE BEEN WORSE THAN THE INDUSTRY AVERAGE OVER THE LAST THREE YEARS.

WHILE THE RESULTS FOR 1985 ARE NOT YET TABULATED, IT IS ANTICIPATED THAT THE REINSURANCE INDUSTRY WILL SHOW A SLIGHT IMPROVEMENT IN RESULTS ALTHOUGH FROM A HISTORICAL POINT OF VIEW, THE IMPROVEMENT WILL NOT DRAMATICALLY IMPROVE CAPACITY, SINCE THE INDUSTRY RESULTS ARE NOT ANYWHERE NEAR ACCEPTABLE LEVELS.

ANOTHER AREA OF CONCERN IS THE ADEQUACY OF LOSS RESERVES ESTABLISHED BY REINSURERS. WHILE IT IS DIFFICULT TO QUANTIFY, CERTAIN OBSERVATIONS CAN BE MADE. TRADITIONALLY, REINSURERS HAVE RECEIVED A MINIMUM OF DATA WITH WHICH THEY MIGHT ASSESS THEIR RESERVE REQUIREMENTS. THE NATURE OF PRO RATA TRANSACTIONS AND BROAD BASE COVERAGES PRECLUDES REINSURERS FROM ESTABLISHING AND MONITORING DETAILED CASE FILES. MOREOVER, THE NORMAL TIMING DELAYS INHERENT IN ANY REINSURANCE TRANSACTION COMPOUND THIS SITUATION. OF PARTICULAR CONCERN ARE THE COMMERCIAL LIABILITY RISKS.

EXPERIENCE FOR THESE RISKS HAS DETERIORATED RAPIDLY IN THE 1980S TO A POINT WHERE THE ENTIRE LINE IS CONSIDERED MOST VOLATILE. THESE RISKS POSE THE GREATEST THREAT TO REINSURERS. AS THE CLAIM AMOUNTS GROW AND THE REPORTING TAIL LENGTHENS, RETENTION LIMITS ARE EXCEEDED. DIRECT WRITERS THEN BEGIN TO LOOK TO THEIR REINSURERS WHO IN TURN ARE LOOKING TO THEIR REINSURERS. INCREASINGLY, REINSURERS ARE BEING CALLED UPON TO PERFORM OBLIGATIONS FOR OLD CONTRACTS THEY PRESUMED WERE FULLY DEVELOPED AND SETTLED YEARS AGO. A STUDY CONDUCTED IN 1983 BY THE REINSURANCE ASSOCIATION OF AMERICA INDICATED THAT APPROXIMATELY 10% OF THE GENERAL LIABILITY LOSSES WERE KNOWN TO REINSURERS AT THE END OF THE FIRST YEAR AND 50% WERE KNOWN BY THE END OF THE FIFTH YEAR. IN A SIMILAR STUDY IN 1985, ONLY 5% OF THE LOSSES WERE KNOWN AT THE END OF THE FIRST YEAR AND IT WASN'T UNTIL THE EIGHTH YEAR THAT 50% OF THE LOSSES WERE KNOWN. THIS SITUATION MAKES LOSS RESERVING AT ADEQUATE LEVELS VERY DIFFICULT FOR REINSURERS.

AS STATED EARLIER, THE 1984 DECLINE IN POLICYHOLDER'S SURPLUS (THE NET AMOUNT DERIVED AFTER DEDUCTING ALL LIABILITIES FROM ASSETS) WAS 7%. THIS DECLINE OCCURRED EVEN THOUGH THERE WERE SOME SUBSTANTIAL INFUSIONS OF NEW CAPITAL INCLUDING THE FOLLOWING:

GENERAL REINSURANCE	279 MILLION
NAC REINSURANCE	54 MILLION

CLARENDON	50 MILLION
KEMPER REINSURANCE	50 MILLION
M & G REINSURANCE	25 MILLION
HOME REINSURANCE	21 MILLION
SECURITY REINSURANCE	7 MILLION
FOLKSAMERICA	5 MILLION

III. REINSURANCE OVERVIEW

A. GENERAL DEFINITION

REINSURANCE IS A FORM OF INSURANCE. IT IS A TRANSACTION WHEREIN THE REINSURER FOR A PREMIUM AGREES TO INDEMNIFY ANOTHER INSURANCE COMPANY, THE CEDING COMPANY OR REINSURED, FOR ALL OR PART OF THE LOSSES WHICH THE LATTER MAY SUSTAIN UNDER ITS INSURANCE POLICIES. IN EXCHANGE FOR ITS PROMISE TO INDEMNIFY, THE REINSURER IS PAID A PART OF THE ORIGINAL PREMIUM THAT THE CEDING COMPANY RECEIVED FOR ISSUING THE POLICY TO THE INSURED.

IMPORTANTLY, REINSURANCE DOES NOT GENERATE ANY ADDITIONAL PREMIUM ON A RISK. THE PREMIUM CHARGED TO THE POLICYHOLDER MUST SUPPORT THE RISK AND BE DIVIDED BETWEEN THE CEDING COMPANY AND THE REINSURER. THE PORTION OF THE ORIGINAL PREMIUM PAID TO THE REINSURER IS USUALLY REDUCED BY COMMISSION PAID TO THE CEDING

COMPANY FOR ITS ACQUISITION EXPENSES. FOR EXAMPLE, AGENTS' COMMISSIONS, TAXES, ETC. ACCORDINGLY, REINSURANCE IS OFTEN DESCRIBED AS THE INSURANCE OF INSURANCE COMPANIES BECAUSE IT PROVIDES REIMBURSEMENT FOR THE CEDING COMPANY'S LOSSES UNDER POLICIES ISSUED BY THE CEDING COMPANY WHICH ARE COVERED BY THE REINSURANCE CONTRACT.

ALTHOUGH THE REINSURER ASSUMES PART OF THE CEDING COMPANY'S RISK FOR A PORTION OF THE PREMIUM, THE CEDING COMPANY REMAINS RESPONSIBLE FOR SERVICING THE BUSINESS THROUGH INVESTIGATION, DEFENDING AND PAYING CLAIMS, SALVAGE OPERATIONS AND OTHER ACTIVITIES. THE USUAL REINSURANCE CONTRACT DOES NOT INVOLVE THE CEDING COMPANY'S POLICYHOLDER WHO LOOKS ONLY TO ITS INSURER (CEDING COMPANY) FOR DEFENSE AND INDEMNIFICATION AGAINST LOSS.

B. PURPOSE AND KINDS OF REINSURANCE

REINSURANCE IS GENERALLY MARKETED THROUGH TWO TYPES OF CONTRACTS--FACULTATIVE AND TREATY. BEYOND THESE TWO BASIC FORMS, THE CONTRACT WILL BE TAILORED TO MEET THE PARTICULAR NEEDS OF A CEDING COMPANY. FACULTATIVE REINSURANCE COVERS A PARTICULAR RISK. A FACULTATIVE AGREEMENT REINSURES A SINGLE INSURANCE POLICY. IT IS GENERALLY A DISCREET TRANSACTION WHICH CAN SERVE A

VARIETY OF PURPOSES SUCH AS REDUCING A CEDING COMPANY'S EXPOSURE IN A SPECIFIC GEOGRAPHIC AREA, REDUCING A CEDING COMPANY'S EXPOSURE ON A PARTICULAR RISK THAT IS NOT OTHERWISE COVERED BY TREATY REINSURANCE, OR PROVIDING EXTRA CAPACITY WHERE A PARTICULAR LARGE RISK EXCEEDS THE CEDING COMPANY'S LIMIT ON SUCH A RISK.

TREATY REINSURANCE ON THE OTHER HAND PROVIDES FOR GENERAL PROTECTION FOR A CEDING COMPANY. IT OBLIGATES THE REINSURED TO ACCEPT ALL BUSINESS OF THE TYPES SPECIFIED IN THE CONTRACT OR TREATY. A TREATY AGREEMENT STIPULATES COVERAGE FOR MANY, SOMETIMES THOUSANDS, OF PRIMARY POLICIES WITHIN A CLASS OR CLASSES OF BUSINESS. FOR EXAMPLE, A TREATY MAY COVER A CEDING COMPANY'S ENTIRE WORKERS COMPENSATION OR PROPERTY BOOK BUSINESS. TREATY REINSURANCE PROVIDES PROTECTION REGARDLESS OF THE QUALITY OF A GIVEN INDIVIDUAL RISK COVERED AND SINCE TREATIES ARE GENERALLY OBLIGATORY ON THE CEDING COMPANY AS WELL, THE REINSURER CAN EXPECT A REGULAR FLOW OF THE INSURANCE COMPANY'S AVERAGE BUSINESS WITHOUT FEAR OF ADVERSE SELECTION. SINCE THE CEDING COMPANY ALSO IS AT RISK TO THE EXTENT THAT IT TYPICALLY RETAINS A PORTION OF EVERY RISK, IT HAS AN INCENTIVE TO PROPERLY UNDERWRITE NEW RISKS AND INVESTIGATE AND DEFEND CLAIMS.

Both treaty and facultative agreements may be based on a pro rata distribution or on an excess of loss basis. Under a pro rata arrangement, the reinsurer and ceding companies share proportionately in premiums and losses. Under an excess agreement, only losses in excess of a pre-determined amount retained by the ceding company (retention) are reinsured.

Pro rata reinsurance in turn may be in the form of a quota share or surplus share. Under a quota share arrangement, the parties agree upon a set proportion of a risk and premium. For example, in an agreement with a split of 25-75% between the ceding company and reinsurer, the reinsurer would be responsible to indemnify the ceding company for 75% of its losses from the first dollar of loss. In contrast, under a surplus share agreement, which is more common in property rather than casualty lines, the parties decide at the time of underwriting on a risk by risk basis the amount to be retained by the ceding company, with a reinsurer sharing proportionately risks with potential liabilities greater than the retained amount. An example of a surplus share agreement would be a proportionate sharing of a risk where the liability exceeds $25,000 retention. A $30,000 liability would be shared 20/30 by the ceding company and 5/30 by the reinsurer for both premiums and losses.

MOST LIABILITY INSURANCE IS WRITTEN ON AN EXCESS OF LOSS BASIS. UNDER AN EXCESS OF LOSS AGREEMENT, THE CEDING COMPANY IS INDEMNIFIED ONLY FOR THE PORTION OF A LOSS THAT EXCEEDS A SPECIFIED RETENTION UP TO A CERTAIN LIMIT. BECAUSE THE REINSURER'S OBLIGATION IS NOT ON A FIRST DOLLAR BASIS, THE PORTION OF THE PREMIUM PAID BY THE PRIMARY COMPANY DOES NOT BEAR A DIRECT PROPORTIONAL RELATION TO THE ORIGINAL PREMIUM. RATHER, THE PROPORTION OF THE PREMIUM PAID TO THE REINSURER IS BASED ON CALCULATION OF THE REINSURER'S RISK OF INCURRING LOSSES GREATER THAN THE AGREED TO RETENTION. THUS A REINSURER MAY AGREE TO ASSUME UP TO $1 MILLION OF RISK IN EXCESS OF $50,000 RETAINED BY THE CEDING COMPANY. HOWEVER, THE PORTION OF THE PREMIUM RETAINED BY THE INSURER WOULD NOT BE BASED ON THE DIRECT RATIO OF RISK RETAINED TO THE RISK CEDED. THE REINSURER'S PORTION OF THE PREMIUM IS CALCULATED SO AS TO REFLECT THE REDUCED CHANCES OF SUFFERING HIGHER LOSSES. GENERALLY, THE FUNDAMENTAL PURPOSE OF REINSURANCE IS TO ENHANCE THE BASIC RISK SPREADING PURPOSE OF INSURANCE. REINSURANCE BENEFITS A CEDING COMPANY BY PROTECTING ITS ENTIRE BOOK OF BUSINESS THROUGH ALLOWING THE CEDING COMPANY TO SPREAD ITS RISK AND LIMIT ITS LIABILITIES FROM LARGE CATASTROPHIC LOSSES.

FOR EXAMPLE, IF A CEDING COMPANY DETERMINES THAT IT HAS

MORE RISK OR A LARGER RISK THAN IT SHOULD IN PRUDENCE OR LAW KEEP IN ITS OWN PORTFOLIO, IT WILL CEDE A PORTION OF THE RISK OR RISKS TO A REINSURER. ILLINOIS LAW FOR EXAMPLE LIMITS THE COMPANY'S MAXIMUM NET RETENTION ON ANY ONE RISK TO 10% OF ITS CAPITAL AND SURPLUS. THE REINSURER'S CAPACITY ALLOWS A GREATER DISTRIBUTION OF RISK FOR THE CEDING COMPANY. THIS RESULT IS ACHIEVED BY INCLUDING THE CEDED PORTION OF THE RISK WITHIN THE REINSURER'S CAPACITY WHICH LIKELY WOULD INCLUDE OTHER RISKS DIFFERENT IN FREQUENCY, GEOGRAPHICAL LOCATION OR KIND. THE CEDED PORTION OF THE RISK MAY IN TURN BE RETROCEDED--THE REINSURER REINSURING PART OF THE RISK--OFFERING FURTHER SPREADING OF THE RISK. THUS, EACH COMPANY PARTICIPATING IN THE RISK WILL PAY ONLY ITS PROPORTIONAL SHARE OF ANY CATASTROPHIC LOSS. THE LOSS WILL BE SPREAD AMONG SEVERAL OR MANY COMPANIES SO THIS IMPACT WILL NOT DEVASTATE ANYONE. WITH EACH TRANSACTION, THE ASSUMING REINSURER RECEIVES A PORTION OF THE ORIGINAL PREMIUM. NO ADDITIONAL PREMIUM IS GENERATED. THE RISK SPREADING EFFECT OF REINSURANCE ALLOWS IT TO SERVE FOUR BASIC FUNCTIONS. FIRST, AS INDICATED, REINSURANCE CAN IMPROVE AN INSURER'S CAPACITY TO SERVE ITS MARKET. SECOND, IT PROTECTS AGAINST CATASTROPHE. THIRD, REINSURANCE STABILIZES THE CEDING COMPANY'S RESULTS. LAST, THE REINSURANCE MAY BE USED TO IMPROVE THE CEDING COMPANY'S FINANCIAL PROFILE.

As earlier indicated, insurers are generally limited in the amount of premium income they may write as a multiple of surplus. Regulators, rating organizations and responsible management pay careful attention to the ratio of premiums to surplus. Reinsurance permits an insurer to write more and larger risks. For example, a property insurer could limit its loss in any one building to $100,000, yet insure a $200,000 building by obtaining reinsurance for the excess over $100,000. The company reduces exposure to $100,000 but obtains the capacity to write a $200,000 risk.

Catastrophic protection is an aspect of reinsurance that protects an insurance company from a large aggregate loss or accumulation of small losses resulting from a single catastrophe. As described previously, the impact of a catastrophic loss is spread through retrocession among several or many companies. Instead of bankrupting the ceding company, it and its reinsurers and the retrocessionaires pay only their individual portions of the loss.

Just as a business or individual buys insurance to spread out inevitable losses, insurers use reinsurance to even out or average their loss experience thereby gaining greater stabilization. Also, an insurer may

USE REINSURANCE TO WITHDRAW FROM A PARTICULAR LINE OF BUSINESS OR GEOGRAPHIC AREA BY CEDING THE ENTIRE LINE OR BOOK OF BUSINESS TO ANOTHER INSURER.

MOST REINSURANCE TRANSACTIONS INCLUDE FINANCIAL ASPECTS. TRADITIONALLY, FINANCING RESULTS FROM THE CEDING COMMISSION OR REPAYMENT TO THE INSURANCE COMPANY OF THE COST OF ACQUISITION OF THE BUSINESS AND REIMBURSEMENT FOR THE STATUTORY REQUIRED RESERVE FOR UNEARNED PREMIUMS. FOR EXAMPLE, WHEN A POLICYHOLDER PAYS A PREMIUM, ONLY PART OF THAT GROSS PREMIUM BECOMES AVAILABLE TO THE INSURANCE COMPANY BECAUSE IT MUST PAY ACQUISITION COSTS SUCH AS COMMISSIONS, TAXES AND A PRESCRIBED PORTION MUST BE ALLOCATED TO THE UNEARNED PREMIUM RESERVE. THUS, ASSUME THE CEDING COMPANY FINDS THAT IT NEEDS $900,000 IN ADDITIONAL SURPLUS TO MAINTAIN A 3 TO 1 PREMIUM TO SURPLUS RATIO. AS ONE FINANCING ALTERNATIVE, IT COULD TRANSFER THROUGH QUOTA SHARE REINSURANCE $2,250,000 IN UNEARNED PREMIUM RESERVE TO A REINSURER AT A 40% CEDING COMMISSION RATE. THE CEDING COMPANY THEN PAYS $2,250,000 LESS 40% OR A NET CASH PAYMENT OF $1,350,000. THE COST OF THE CEDING COMPANY IS THE PROFIT, IF ANY, ON THE BUSINESS TO THE REINSURER PLUS THE LOSS OF INVESTMENT INCOME OF THE AMOUNT PAID.

JUST AS INSURANCE COMPANIES PURCHASE PROTECTION SO ALSO DO REINSURERS CEDE OR PASS OFF PART OF THE RISKS THEY

ASSUME FROM INSURANCE COMPANIES TO OTHER REINSURERS, RETROCESSIONAIRES, AND PAY THEM AN AGREED UPON PORTION OF THE PREMIUM BUT THE REINSURANCE IS AN INSURANCE COMPANY'S FIRST LINE OF RESOURCES. THE INSURANCE COMPANY IS GENERALLY LIABLE FOR THE LOSS TO ITS POLICYHOLDERS. THE REINSURER IS CONTRACTUALLY OBLIGATED TO PAY ITS SHARE OF THE LOSS TO THE PRIMARY COMPANY UPON THE PRIMARY COMPANY'S PAYMENT OF THE LOSS. IN TURN, THE REINSURER MAY RECOVER FROM ITS RETROCESSIONAIRE. IMPORTANTLY, THE INSURANCE COMPANY MUST PAY ITS POLICYHOLDERS RECOVERED LOSSES REGARDLESS OF RECOVERY FROM ITS REINSURER AND THE REINSURER IS OBLIGATED TO PAY REGARDLESS OF RECOVERY FROM ITS RETROCESSIONAL PROGRAM.

C. LIMITS OF REINSURANCE

REINSURANCE CANNOT ALTER THE INHERENT NATURE OF THE BUSINESS BEING REINSURED. A REINSURANCE AGREEMENT DOES NOT MAKE AN INHERENTLY UNINSURABLE RISK INSURABLE, NOR CAN REINSURANCE CHANGE AN UNDERPRICED RISK INTO AN ADEQUATELY PRICED RISK. AN ATTEMPT TO GUARANTEE PLACEMENT OF A POOR RISK THROUGH THE USE OF A MANDATED REINSURANCE MECHANISM WOULD MERELY SPREAD THE NEGATIVE RESULTS AMONG INSURERS. IT WOULD NOT CHANGE THE UNPROFITABLE BUSINESS INTO A PROFITABLE BUSINESS. THE EFFECT WOULD BE A SUBSIDY DOING NOTHING TO SOLVE THE

BASIC PROBLEMS THAT RENDER THE RISK UNPROFITABLE. REINSURERS EVALUATE THE UNDERWRITING AND MONITOR THE CLAIM FUNCTIONS OF INSURANCE COMPANIES. IF THE EVALUATION RESULTS IN A CONCLUSION THAT THE PRICE CHARGED FOR A RISK IS ADEQUATE TO SUPPORT THAT RISK AND THAT THE INSURANCE COMPANY HAS THE ABILITY TO PROTECT ITS OWN INTEREST THROUGH PROPER CLAIM SERVICE, THEN THE REINSURER MAY CHOOSE TO ALLOCATE ITS RESOURCES IN FAVOR OF ASSUMING PART OF THE RISK FOR AN APPROPRIATE PART OF THE PREMIUM. THE CRITICAL JUDGMENT OF BOTH THE INSURANCE COMPANY AND THE REINSURER IS THE UNDERWRITING JUDGMENT OF HOW MUCH SHOULD BE CHARGED FOR A GIVEN RISK. THE PRICING OF THAT RISK OBVIOUSLY REQUIRES AMONG OTHER THINGS A DETERMINATION OF THE LIKELIHOOD OF AN EVENT HAPPENING IN THE FUTURE AND A TREATMENT OF THAT EVENT UNDER THE PREVAILING SOCIAL/LEGAL SYSTEM. ACCORDINGLY, REINSURERS ARE RISK SPREADERS, THEY ARE NOT BANKERS WHICH PAY INTEREST FOR HOLDING FUNDS DEPOSITED BY INSURANCE COMPANIES.

REINSURANCE CONTRACTS ARE INDIVIDUALLY TAILORED TO THE NEEDS OF THE CEDING COMPANIES. THERE IS A GREAT DEAL OF COMPETITIVE VARIATION IN HOW AGREEMENTS ARE STRUCTURED AND PRICED. NEVERTHELESS, REINSURANCE, LIKE INSURANCE, DEPENDS ON REASONABLE PREDICTABILITY OF RISK.

D. REINSURANCE UNDERWRITING

UNDERWRITING IS MORE A SUBJECTIVE THAN AN OBJECTIVE DISCIPLINE. IT IS MORE ART THAN SCIENCE. AN INSURER'S UNDERWRITERS WILL BE ATTRACTED TO AND WILL ASSUME THOSE RISKS THAT THEY PERCEIVE TO BE INSURABLE. THIS MEANS THAT THEY WILL BE ATTRACTED TO AND ASSUME THOSE RISK THAT THEY PERCEIVE AS NOT UNDULY ENDANGERING THEIR COMPANY'S SURPLUS AND THAT THEY PERCEIVE AS PROVIDING A REASONABLE EXPECTATION OF PROFIT.

THE MECHANISM OF INSURING FOR ASSUMING RISKS INVOLVES CERTAIN BASIC PRINCIPLES AND WILL WORK ONLY WHEN THESE PRINCIPLES ARE MET. THESE PRINCIPLES MAY BE STATED AS FOLLOWS:

1. A LARGE NUMBER OF SIMILAR BUT INDEPENDENT RISKS EXIST. THIS SERVES TO REDUCE VARIATION OF RESULT AND PROVIDE A REASONABLE PREDICTABILITY OF LOSS. THIS PRINCIPLE IS REFERRED TO AS THE LAW OF LARGE NUMBERS.

2. THE MAXIMUM LOSS ON ANY INDIVIDUAL RISK IS REASONABLY IDENTIFIABLE AND MEASURABLE.

3. THE PREMIUM CHARGE FOR ALL RISKS OF A LIKE KIND IS SUFFICENT TO COVER AGGREGATE EXPECTED LOSSES AND

EXPENSES AND TO PROVIDE SOME PROFIT. OFTEN THIS PREMIUM IS MODIFIED IN RECOGNITION OF INVESTMENT INCOME, PARTICULARLY IN THE CASUALTY LINES.

4. WHERE NECESSARY, SPREAD OF RISK IS ACHIEVED BY SHARING THE ASSUMED RISK WITH OTHER REINSURERS.

AS THE LAST POINT ABOVE INDICATES, INSURANCE COMPANIES TAKE FURTHER ADVANTAGE OF THE LAW OF LARGE NUMBERS BY PROCURRING REINSURANCE. AS NOTED EARLIER, THEY DO THIS BECAUSE THEY HAVE TOO FEW RISKS OF A CERTAIN KIND OR SIZE FOR THE LAW OF LARGE NUMBERS TO APPLY; OR AN INSURER MAY HAVE INSUFFICIENT SURPLUS TO ABSORB VARIATIONS BEYOND A CERTAIN LOSS LEVEL. THE LARGER THE COMPANY IN TERMS OF SURPLUS AND THE MORE INDEPENDENT RISKS OF A CERTAIN KIND IT IS ABLE TO COVER, THE LESS IT WILL NEED REINSURANCE; HOWEVER, SOME RISKS ARE SO LARGE THAT VIRTUALLY ANY COMPANY WOULD REQUIRE REINSURANCE.

JUST AS WITH PRIMARY INSURANCE, REINSURANCE FUNCTIONS BEST WHEN REINSURERS ASSUME MANY RISKS THAT ARE ALIKE BUT INDEPENDENT THUS ALLOWING THE LAW OF LARGE NUMBERS TO WORK. A REASONABLE ESTIMATE OF EXPECTED LOSSES OVER TIME IS NECESSARY SO THAT A RATE MAY BE CHARGED TO COVER THE LOSS AMOUNT, PROTECT SURPLUS AND PROVIDE A PROFIT. THE REINSURER MUST ALSO HAVE SUFFICIENT

SURPLUS TO ABSORB FLUCTUATIONS DUE TO THE UNEXPECTED. LASTLY, A SUCCESSFUL REINSURANCE PROGRAM REQUIRES THE AVAILABILITY OF RETROCESSIONAIRES FOR VERY LARGE RISKS.

WHILE THERE ARE MANY SIMILARITIES BETWEEN THE PRINCIPLES OF UNDERWRITING DIRECT INSURANCE AND REINSURANCE, THERE ARE CERTAIN KEY DISTINCTIONS BETWEEN THE TWO THAT HAVE CAUSED GREATER NEGATIVE IMPACT ON REINSURERS THAN INSURERS FROM INCREASING LITIGATION, LARGER AWARDS AND EXPANDING LIABILITY THEORIES.

FIRST, DIRECT COMPANIES SHARE OR REINSURE THAT BUSINESS WHICH THEY PERCEIVE TO BE CHARACTERIZED BY A HIGHER DEGREE OF VARIATION OF LOSS. THEREFORE, THE REINSURER IS MORE HEAVILY EXPOSED ON THE MORE DIFFICULT RISK THAN THE PRIMARY COMPANY. THOSE RISKS WITH HIGHER LOSS POTENTIAL ARE TYPICALLY THOSE WHICH ARE MORE HEAVILY REINSURED. SECOND, EXCESS OF LOSS AGREEMENTS CAUSE REINSURERS TO SUFFER MORE THAN PRIMARY COMPANIES FROM ECONOMIC AND SOCIAL INFLATION. THIRD, REINSURANCE CLAIM EXPERIENCE AS PREVIOUSLY NOTED TAKES LONGER TO DEVELOP CAUSING A GREATER LIKELIHOOD OF UNDERESTIMATING ULTIMATE LOSSES.

AS INDICATED, CASUALTY BUSINESS MAY BE REINSURED IN ONE OF TWO WAYS. QUOTA SHARE REINSURANCE INVOLVES SHARING A FIXED PORTION OF PREMIUMS AND LOSSES BETWEEN DIRECT

COMPANIES AND REINSURERS. THIS FORM OF REINSURANCE IS INFREQUENTLY USED FOR CASUALTY BUSINESS BECAUSE OF THE HIGH COST TO THE DIRECT COMPANY. DIRECT COMPANIES HAVE NO DESIRE TO SHARE ALL CASUALTY RISKS WITH REINSURERS; RATHER, THEY NATURALLY CHOOSE TO SHARE ONLY THOSE WHICH WOULD PRESENT THE GREATEST LOSS POTENTIAL OR VARIABILITY.

THUS, MOST CASUALTY LINES ARE REINSURED ON AN EXCESS OF LOSS BASIS. IT WILL BE RECALLED THAT EXCESS OF LOSS REINSURANCE INDEMNIFIES THE CEDING COMPANY AGAINST ALL OR A PORTION OF THE AMOUNT OF RISK IN EXCESS OF SPECIFIED RETENTION. AN EXAMPLE WOULD BE WHERE A GENERAL LIABILITY INSURER WRITES POLICY LIMITS OF UP TO $1 MILLION PER OCCURRENCE, RETAINS $100,000 AND REINSURES THE $900,000 EXCESS. FOR THE INSURER, THE VARIABLE OF LOSS FROM A SINGLE OCCURRENCE IS REDUCED FROM $1 MILLION TO $100,000.

THERE ARE BASICALLY TWO METHODOLOGIES FOR PRICING EXCESS OF LOSS REINSURANCE. THE FIRST, KNOWN AS EXPOSURE RATING OR MANUAL EXCESS RATING, APPORTIONS THE PREMIUMS PAID BY THE INSURER BETWEEN THE PRIMARY INSURER AND THE EXCESS REINSURER ON THE BASIS OF BROAD INDUSTRY DATA ABOUT THE RESPECTIVE RELATIVE LOSS EXPOSURE OF THE TWO PARTIES. THE SECOND METHOD, KNOWN AS LOSS RATING OR EXPERIENCE RATING, USES THE PRIMARY

INSURER'S OWN LOSS DATA TO PROJECT EXCESS COSTS. REGARDLESS OF THE METHOD USED (WHETHER INDUSTRY DATA OR INDIVIDUAL INSURER DATA IS THE BASIS), HEAVY RELIANCE IS PLACED ON AN HISTORICAL LOSS EXPERIENCE. CRITICAL TO THE PRINCIPLES OF REINSURANCE RATE EVALUATION IS THE ABILITY TO EXTRAPOLATE FUTURE TRENDS FROM PAST EXPERIENCE. RATES ARE COMPOSED OF FOUR COMPONENTS:

1. A PROVISION FOR CLAIMS, WHICH IS BASED ON THE EXPECTED NUMBER OF LOSSES WHICH WILL OCCUR AND THE ESTIMATED ULTIMATE COST OF THOSE LOSSES.

2. A PROVISION FOR EXPENSES (INCLUDING ATTORNEY FEES AND LEGAL EXPENSES) THAT WILL BE INCURRED.

3. A PROVISION FOR PROFIT, TO REWARD THE INSURER FOR ASSUMING RISK AND EXPOSING ITS CAPITAL.

4. A PROVISION FOR CONTIGENCIES WHICH PROVIDES FOR VARIATIONS IN THE EXPECTED COSTS OF ONE AND TWO ABOVE.

RELIABLE ESTIMATES OF FUTURE COSTS BEGIN WITH THE CONSIDERATION OF PAST LOSS AND EXPENSE EXPERIENCE, WHICH ARE MODIFIED TO PREDICT FUTURE LOSS AND EXPENSE EXPERIENCE. THE TWO MOST IMPORTANT MODIFICATIONS TO THE HISTORICAL EXPERIENCE ARE FOR TREND AND LOSS

DEVELOPMENT.

TREND FACTORS ARE USED TO ADJUST THE LOSS AND EXPENSE FROM THE HISTORICAL TIME OF THE EXPERIENCED PERIOD TO THE FUTURE TIME WHEN THE INSURANCE OR REINSURANCE COVERAGE WILL BE IN EFFECT. TREND FACTORS REFLECT THE RATE OF CHANGE IN CLAIM FREQUENCIES, CLAIM SEVERITIES AND EXPENSES. TREND FACTORS REALLY MEASURE CHANGES IN THE ECONOMIC, LEGAL AND SOCIAL ENVIRONMENT.

ECONOMIC TREND IS THE EASIEST TREND TO PREDICT. IT MEASURES CHANGES IN THE COSTS OF GOODS AND SERVICES THAT THE INSURANCE PAYS FOR. ECONOMIC TREND IMPACTS PRIMARY INSURERS DIFFERENTLY THAN EXCESS OF LOSS REINSURERS. CONSIDER THE $100,000 CLAIM WHICH BECOMES $110,000 THROUGH INFLATION. IF THE PRIMARY COMPANY HAS A RETENTION OF ITS REINSURANCE CONTRACT OF $500,000, THEN IT WILL FEEL THE ENTIRE INFLATIONARY EFFECT. HOWEVER, IF THE RETENTION IS $100,000 OR LESS, THE CEDING COMPANY PASSES ALL OF THE EFFECT OF INFLATION TO THE REINSURER. THE POTENTIAL IMPACT ON THE EXCESS OF LOSS REINSURER OF THIS LATTER PHENOMENON OFTEN REFERRED TO AS THE "LEVERAGED EFFECT OF INFLATION" CAN BEST BE ILLUSTRATED THROUGH THE FOLLOWING EXAMPLES OF THREE CLAIMS BEFORE AND AFTER A 10% ECONOMIC TREND (ASSUMING A $100,000 RETENTION).

CLAIM	COST BEFORE INFLATION			COST AFTER INFLATION		
#	TOTAL	REINSURED	REINSURER	TOTAL	REINSURED	REINSURER
1	85,000	85,000	0	93,500	93,500	0
2	95,000	95,000	0	104,500	100,000	4,500
3	105,000	100,000	5,000	115,000	100,000	15,500
TOTAL	285,000	280,000	5,000	313,500	293,500	20,000

ALTHOUGH IN THIS EXAMPLE INFLATION IS 10% OVERALL, THE EXCESS OF LOSS REINSURANCE COVERAGE HAS STABILIZED THE PRIMARY COMPANY'S RESULTS BY LIMITING INFLATION TO ONLY 4.8% (293,500 VS. $280,000). YET THE REINSURER HAS EXPERIENCED INFLATION OF 300% (20,000 VS. 5,000).

LEGAL TREND REFERS TO THE CHANGE IN LOSS COSTS WHICH OCCUR AS A RESULT OF CHANGES IN THE TYPES OF LOSSES COVERED BY AN INSURANCE OR REINSURANCE AGREEMENT. LIABILITIES MAY BE EXPANDED, AS MANY HAVE BEEN, OR THEY MAY BE LIMITED.

RECENT COURT DECISIONS HAVE CREATED NEW TYPES OF CLAIMS THAT WERE NOT ANTICIPATED WHEN POLICIES WERE WRITTEN. IN SUCH AN ENVIRONMENT, HISTORICAL DATA BECOMES VERY UNRELIABLE FOR PREDICTORS OF FUTURE LOSSES AND AS WITH ECONOMIC TRENDS, REINSURERS SUFFER DISPROPORTIONATELY WHEN UNANTICIPATED LIABILITIES ARE CREATED AND UNEXPECTED LOSSES

ARE IMPOSED. THE EXCESS OF LOSS TREATY WILL LIMIT THE CEDING COMPANY'S EXPOSURE. THE MAJORITY OF THE INCREASE WILL BE FELT IN THAT PORTION OF THE RISK REINSURED.

SOCIAL INFLATION IS A PHRASE THAT REFERS TO BOTH THE INCREASED PROPENSITY ON THE PART OF THE U.S. PUBLIC TO SUE OR SEEK RELIEF FOR LIABILITY DAMAGES AS WELL AS THE INCREASINGLY LARGER PLAINTIFF JUDGMENTS BEING AWARDED FOR SETTLEMENTS. THE FORMER INCREASES FREQUENCY OF LOSSES; THE LATTER INCREASES SEVERITY OF LOSSES. AGAIN AS WITH ECONOMIC INFLATION, SOCIAL INFLATION IS FELT MORE BY EXCESS OF LOSS REINSURERS.

SOCIAL INFLATION AND OTHER RELATED CHANGES IN THE CIVIL JUSTICE SYSTEM ARE DEALT WITH LATER IN THIS PAPER. FOR NOW IT IS SUFFICIENT TO NOTE THAT THE ACTUARY MUST TAKE ALL THREE KINDS OF TRENDS-ECONOMIC, LEGAL AND SOCIAL-INTO ACCOUNT WHEN DETERMINING THE PREMIUM TO BE CHARGED. WHEN THE INHERENT RISK CANNOT BE QUANTIFIED DUE TO THE LACK OF PREDICTABILITY, THE ACTUARY AND THE UNDERWRITER MUST CONCLUDE THAT THE RISK IS NOT INSURABLE. THIS IS TRUE WHETHER THE RISK IS AN UNDERLYING INSURED OR A PRIMARY COMPANY THAT IS BEING REINSURED.

THE MAJOR DIFFERENCE BETWEEN INSURANCE AND REINSURANCE IS THAT EXCESS OF LOSS REINSURANCE TRENDING IS EVEN LESS PREDICTABLE THAN OVERALL TRENDING DUE TO THE

LEVERAGE EFFECT OF ECONOMIC, LEGAL AND SOCIAL INFLATION ALREADY DESCRIBED. PREDICTABILITY FOR REINSURERS IS ALSO MADE MORE DIFFICULT BECAUSE, AS NOTED EARLIER, LOSS DEVELOPMENT IS SLOWER FOR EXCESS OF LOSS COVERAGE THAN IT IS FOR PRIMARY COVERAGE.

LIABILITY INSURANCE POLICIES GENERALLY COVER CLAIMS ARISING FROM INCIDENTS HAPPENING IN A GIVEN YEAR. HOWEVER, SUCH CLAIMS MAY NOT BE REPORTED TO THE INSURER UNTIL LONG AFTER THE INCIDENT HAS OCCURRED. FOR EXAMPLE, A PHYSICIAN MAY DELIVER A CHILD IN A GIVEN YEAR. MANY YEARS LATER AS THE CHILD APPROACHES ADOLESCENCE, ABNORMALITIES IN THE CHILD MAY BECOME APPARENT WHICH ARE SUSPECTED TO HAVE BEEN CAUSED BY SOME ASPECT OF THE DELIVERY. A SUIT MIGHT THEN BE FILED WHICH COULD TAKE YEARS TO RESOLVE IN THE COURT SYSTEM. THUS, WHEN USING PRIOR YEARS EXPERIENCE IN PRICING, ADJUSTMENTS MUST BE MADE FOR THE CLAIMS YET TO BE RECORDED. THIS EMERGENCE OF CLAIMS OVER TIME IS KNOWN AS LOSS DEVELOPMENT. THE REPORTING OF LOSSES OCCURS VERY SLOWLY ON THE EXCESS LIABIILTY BUSINESS WRITTEN BY REINSURERS. FOR EXAMPLE, A RECENT REINSURANCE ASSOCIATION OF AMERICA STUDY HAS SHOWN THAT AFTER FOUR YEARS REINSURERS ONLY KNOW OF 20% OF THE MEDICAL MALPRACTICE AND GENERAL LIABILITY LOSSES THAT WILL ULTIMATELY BE REPORTED. THIS REPORTING IS MUCH SLOWER THAN EXPERIENCED BY PRIMARY COMPANIES WHICH

WOULD KNOW OF 90% AND 85% RESPECTIVELY OF THEIR ULTIMATE LOSSES FOR THOSE LINES OF BUSINESS. REINSURANCE EXCESS LIABILITY REPORTING PATTERNS HAVE SHOWN A MOVEMENT TOWARDS SLOWER AND SLOWER REPORTING OVER TIME. THE MAJOR REASON FOR THIS DIFFERENCE BETWEEN PRIMARY AND REINSURANCE DEVELOPMENT PATTERNS IS THE RETENTION FEATURE OF EXCESS OF LOSS REINSURANCE. SINCE MANY CLAIMS ARE NOT VALUED AT ULTIMATE COSTS INITIALLY, THE PRIMARY INSURER MAY NOT REPORT SUCH CLAIMS TO ITS REINSURER UNTIL CONSIDERABLE TIME HAS PASSED BECAUSE THE INITIAL RESERVE IS WITHIN THE PRIMARY COMPANY'S RETENTION. THE RELATIVE DEVELOPMENT IS MUCH LARGER FOR THE REINSURER THAN THE PRIMARY INSURER SINCE THE PRIMARY COMPANY'S NET LOSS ON ANY CLAIM IS LIMITED FOR ANNUAL STATEMENT PURPOSES TO ITS RETENTION.

THIS INCREASE IN THE PROPORTION OF UNREPORTED CLAIMS INCREASES THE UNCERTAINTY OF PRICING ESTIMATES WHICH ARE BASED ON A PREDICTION OF THE ULTIMATE AMOUNT OF CLAIMS THAT WILL BE EXPERIENCED FOR A GIVEN YEAR. WITH REINSURANCE EXPERIENCING SIGNIFICANT CLAIM ACTIVITY 15 TO 20 OR MORE YEARS AFTER BUSINESS WAS WRITTEN, THE LOSS DEVELOPMENT IS BEGINNING TO APPEAR ENDLESS AS NEW AND UNANTICIPATED KINDS OF CLAIMS ARE MADE AGAINST INSURANCE COVERAGE PROVIDED DECADES AGO. AS THE CURRENT PACE OF LITIGATION IN SOCIETY ACCELERATES, REINSURERS WILL FIND IT INCREASINGLY DIFFICULT TO PRICE TODAY'S COVERAGE SO AS TO CONTEMPLATE CONDITIONS IN THE YEARS TO COME. HISTORICAL LOSS DEVELOPMENT FACTORS ARE BECOMING MUCH LESS MEANINGFUL FOR USE IN PRICING TODAY'S BUSINESS. ASBESTOS, AGENT ORANGE AND DS ARE ALL EXAMPLES OF NEW KINDS OF CLAIMS HAVING A MAJOR IMPACT ON BUSINESS WRITTEN MANY YEARS AGO AND THERE ARE MANY OTHERS.

E. REINSURANCE ILLUSTRATION

WHILE THE PRECEDING PAGES MENTIONED WHAT THE PURPOSES OF REINSURANCE ARE AND THE VARIOUS TYPES, THE FOLLOWING ILLUSTRATION IS INTENDED TO SHOW HOW TYPICAL RISKS WOULD BE COVERED AND HOW SEVERAL REINSURERS WOULD BE INVOLVED UNDER VARIOUS TYPES OF AGREEMENTS TO PROVIDE THE COVERAGE DESIRED:

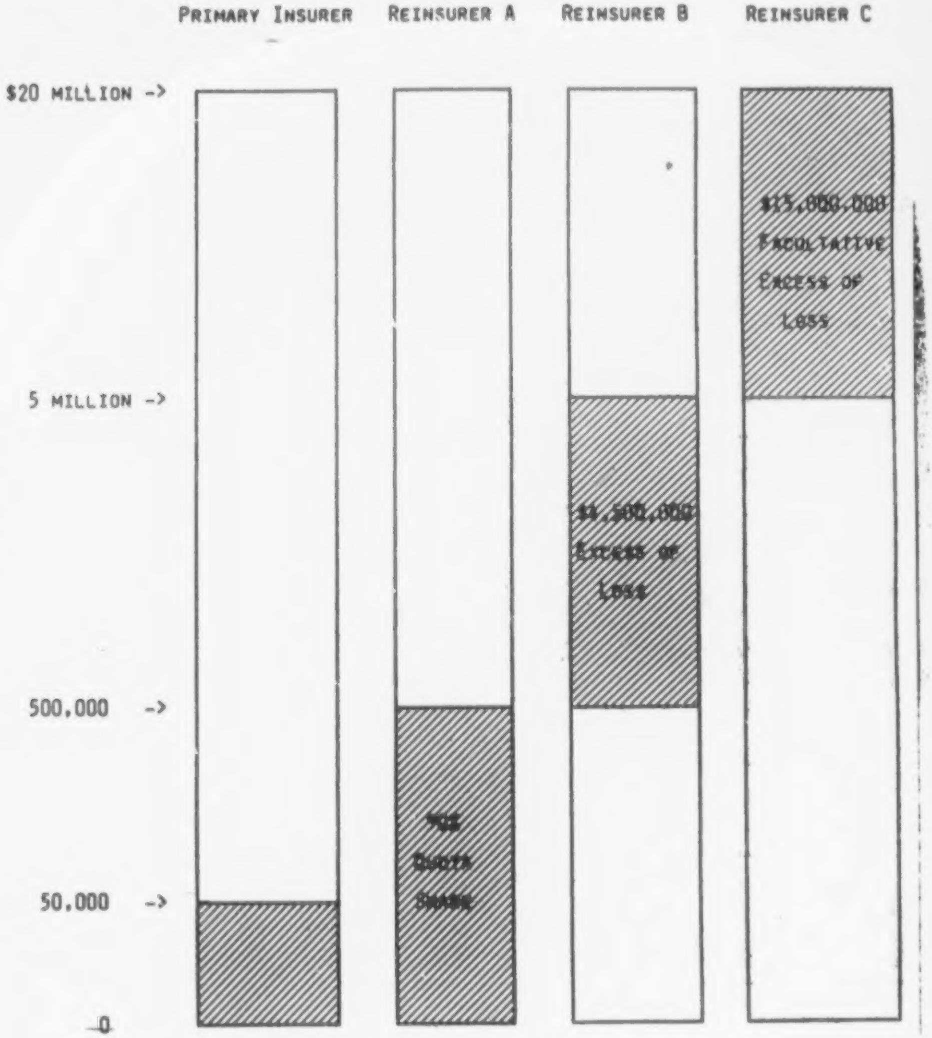
INSURED IS THE XYZ MANUFACTURING COMPANY COVERED UNDER A FIRE INSURANCE POLICY ON AN INDUSTRIAL SITE. THE PRIMARY COMPANY ISSUES THE FIRE POLICY FOR THE BUILDING AT LIMITS OF LIABILITY TO $20 MILLION.

THE POLICY IS COVERED AUTOMATICALLY UNDER TWO OF THE PRIMARY COMPANY'S EXISTING REINSURANCE TREATIES. THE COMPANY'S FIRST LAYER OF REINSURANCE PROTECTION IS A 90% QUOTA SHARE WITH REINSURER A WITH A TREATY LIMIT OF

$500,000. UNDER THIS AGREEMENT, THE PRIMARY INSURER'S MAXIMUM EXPOSURE TO LOSS IS $50,000 OR 10% OF THE TREATY LIMIT.

THE SECOND REINSURANCE TREATY IS AN EXCESS OF LOSS TREATY WITH REINSURER B WHICH COVERS LOSSES IN EXCESS OF $500,000 UP TO A LIMIT OF $5 MILLION. SINCE XYZ MANUFACTURING COMPANY'S FIRE POLICY IS FOR $20 MILLION, THE PRIMARY INSURER NEEDS A THIRD LAYER OF REINSURANCE TO COVER THE REMOTE POSSIBILITY THAT LOSSES WOULD EXCEED $5 MILLION. IT DECIDES TO PURCHASE EXCESS OF LOSS PROTECTION FROM ONE OF ITS FACULTATIVE INSURERS.

THE CHART WHICH FOLLOWS ILLUSTRATES THE AFFORE DESCRIBED COVER.


PRIMARY INSURER
REINSURER A
REINSURER B
REINSURER C
$20 MILLION ->
5 MILLION ->
500,000 ->
50,000 ->
0
90% QUOTA SHARE
$4,500,000 EXCESS OF LOSS
$15,000,000 FACULTATIVE EXCESS OF LOSS

THE FOREGOING EXAMPLE OF THE LAYERING OF REINSURANCE PROTECTION IS A SIMPLIFIED ONE TO ILLUSTRATE CONCEPTS. IN ACTUAL PRACTICE, RETENTION LEVELS AND PLACEMENTS WOULD VARY CONSIDERABLY BASED ON THE SIZE OF THE COMPANIES INVOLVED, EXISTING COVERS AND PRICE CONSIDERATIONS.

ASSUMING THAT A FIRE CAUSED A $2 MILLION LOSS, THE PRIMARY COMPANY WOULD PAY $50,000, REINSURER A WOULD PAY $450,000 AND REINSURER B WOULD PAY THE REMAINING $1.5 MILLION.

IV. PROBLEMS IN THE REINSURANCE MARKETS

CERTAINLY ONE OF THE FACTORS THAT HAS EXACERBATED THE AFFORDABILITY AND AVAILABILITY OF INSURANCE FROM PRIMARY COMPANIES HAS BEEN THEIR INABILITY TO ACQUIRE REINSURANCE COVER. THIS SECTION WILL DISCUSS THE VARIOUS FACTORS THAT HAVE RESTRICTED THE AVAILABILITY OF REINSURANCE COVER.

CAPACITY EXPLOSION

ACCORDING TO MANY SOURCES, THE NUMBER OF PROFESSIONAL REINSURERS INCREASED TWO TO THREE FOLD FROM THE EARLY 70S TO THE EARLY 80S. THIS IS WHAT IS CALLED A CAPACITY EXPLOSION AND THE EMERGENCE OF WHAT IS REFERRED TO AS 'INNOCENT' REINSURANCE CAPACITY.

BEFORE THE 1960S THE REINSURANCE MARKET CONSISTED OF A

SMALL NUMBER OF PROFESSIONAL REINSURERS WHO PURSUED STRICT AND CONSERVATIVE UNDERWRITING POLICIES. HOWEVER, AS THE WORLD ECONOMY EXPANDED, NEW TYPES OF RISKS EMERGED WITH MUCH LARGER VALUES THAN BEFORE. NUCLEAR POWER STATIONS, SUPER TANKERS AND JUMBO JETS REQUIRED AN UNDERWRITING CAPACITY OF VAST PROPORTION. SUPERIMPOSED ON THIS WAS A CONTRACTION OF INSURANCE CAPACITY IN THE U.S. IN THE EARLY 1970S. THE FALL IN STOCKMARKET VALUES AFFECTED COMPANY SOLVENCY MARGINS AND HENCE THEIR ABILITY TO RETAIN BUSINESS. THEY THEREFORE REINSURED HEAVILY. WHERE DID THE NEW CAPACITY COME FROM? CERTAINLY ONE ELEMENT WAS THE GROWTH OF CAPTIVES WHICH WERE PRESSURED INTO NON-PARENT INSURANCE BUSINESS BY CHANGES IN THE U.S. TAX CODE. THE SECOND MAJOR SOURCE OF NEW CAPACITY CAME FROM THE DIRECT INSURERS WHO BEGAN TO UNDERTAKE REINSURANCE AS A NEW AND PROMISING EXTENSION OF THEIR OPERATIONS. A THIRD MAJOR SOURCE WAS COMPANIES FROM THE THIRD WORLD THAT WERE DEVELOPED. FINALLY, A NUMBER OF DIRECT COMPANIES WHICH DID NOT WISH OR COULD NOT ESTABLISH THEIR OWN REINSURANCE COMPANIES PARTICIPATED IN SO CALLED 'BROKER POOLS' IN WHICH THEY AUTHORIZED A BROKER TO ACCEPT REINSURANCE ON THEIR BEHALF. MANY OF THESE NEW ENTRANTS REALLY DID NOT UNDERSTAND THE NATURE OF THE REINSURANCE BUSINESS BUT WERE ATTRACTED TO IT BECAUSE LARGE AMOUNTS OF CASH COULD BE GENERATED AT RELATIVELY LOW COST THAT COULD BE INVESTED AT HIGH YIELDS.

THE RESULT OF THIS NEW CAPACITY AND COMPETITION WAS THE UNDER-CUTTING OF RATES CHARGED BY THE ESTABLISHED PROFESSIONAL REINSURERS AND PUTTING THOSE COMPANIES UNDER PRESSURE TO CONFORM OR LOSE BUSINESS. THE PRACTICE OF CASH FLOW UNDERWRITING WAS PRESENT NOT ONLY IN THE PRIMARY MARKET BUT ALSO IN THE REINSURANCE MARKETPLACE AS REINSURERS SLASHED RATES AND COMPROMISED SOUND UNDERWRITING PRINCIPLES TO OBTAIN OR RETAIN BUSINESS.

IN THE EARLY AND MID 1980S, THE REINSURANCE INDUSTRY BEGAN TO EXPERIENCE ADVERSE OPERATING RESULTS DUE TO THE DECLINE IN INVESTMENT INCOME AND DEVELOPING LOSS EXPERIENCE WHICH CAUSED MARKET CAPACITY TO DIMINISH. LONG STANDING PROFESSIONAL REINSURERS LIKEWISE EXPERIENCED ADVERSE RESULTS AND REDUCED PARTICIPATION IN THE MARKETPLACE. TABLE 2 OF THE APPENDIX PRESENTS A LIST OF SOME OF THE U.S. AND OTHER COMPANIES THAT HAVE CEASED ACCEPTING REINSURANCE. A CLOSE EXAMINATION OF THIS LIST WILL SHOW THAT A NUMBER OF INSURERS SUFFERED ADVERSE RESULTS SO EXTREME AS TO CAUSE LIQUIDATION. ALSO, THE LIST SHOWS SOME OF THE SUBSIDIARIES OF INDUSTRIAL CONCERNS OR OF FOREIGN COMPANIES THAT SUFFERED POOR RESULTS AND WITHDREW FROM THE REINSURANCE MARKET. THE DISAPPEARANCE OF THESE COMPANIES FROM THE REINSURANCE MARKETPLACE HAS CAUSED A SERIOUS CAPACITY VOID AND HAS IMPACTED ON PRIMARY COMPANIES WHO RELIED ON THESE CONCERNS FOR REINSURANCE COVER.

REACTION OF ALIEN COMPANIES

HISTORICALLY, ALIEN COMPANIES, INCLUDING LLOYDS OF LONDON, HAVE PROVIDED A RELIABLE AND STRONG MARKET FOR U.S. RISKS. AS WILL BE DISCUSSED, THIS CAPACITY HAS BEEN SHRINKING FOR THE LAST TWO YEARS. MUCH OF THE CONCERN OF ALIEN REINSURERS STEMS FROM WHAT THEY PERCEIVE AS PROBLEMS WITH THE U.S. CIVIL JUSTICE SYSTEM. GENERALLY, THEY FEEL THAT THE UNITED STATES HAS GONE LITIGATION CRAZY AND THAT THE CIVIL JUSTICE SYSTEM HAS BECOME UNPREDICTABLE AND IMBALANCED. IN SIMPLE TERMS, THEY FEEL THAT AMERICANS REGARD THE CIVIL JUSTICE SYSTEM AS A LOTTERY WHERE THEIR LAWSUITS, REGARDLESS OF MERIT, MAY BE THE TICKET TO A BIG PAYMENT. THIS MENTALITY, THEY FEEL, IS PUSHING THE LIABILITY SYSTEM BEYOND INSURABLE LIMITS. ALSO, THEY ARE CONCERNED ABOUT HOW THE U.S. COURTS WILL INTERPRET OR MORE SUCCINCTLY, MISINTERPRET, VARIOUS INSURANCE POLICY WRITINGS.

WHETHER ONE VIEWS THESE OBSERVATIONS AS CORRECT OR NOT, THEY REPRESENT THE FEELINGS OF ALIEN REINSURERS AND, AS A RESULT, THEY HAVE RESTRICTED THEIR WRITINGS IN THE U.S. OR SUBSTANTIALLY MODIFIED THEIR TERMS.

THIS REACTION OF ALIEN COMPANIES HAS CAUSED A FURTHER CONSTRICTION OF THE AVAILABILITY OF REINSURANCE PROTECTION FOR U.S. COMPANIES.

Unpredictability and Cost of the Civil Justice System

As was discussed in an earlier section, a reinsurance underwriter must be able to predict and establish price levels for future losses. If the underwriter does not have confidence in the historical data of loss experience, he or she will not underwrite the risk. It is the view of the U.S. reinsurance industry that the current judicial trends expanding liabiilty and imposing coverage where none was intended make it impossible to predict and price certain risks.

The reinsurance industry cites a number of examples in several different areas to support the conclusion that the civil justice system is changing the profile of U.S. casualty losses and increasing the cost and frequency of loss to unpredictable levels.

- In 1940 there were 35,000 civil suits filed in the U.S. Federal System. By 1982 the number had climbed to 206,000. By the end of 1985 new civil cases were running at twice the level that they were in 1979.

- In 1984 there were 12 million civil suits pending in state courts. From 1977 to 1981 state filings had increased by 22%.

- First verdict of $1 million or greater was awarded in 1962. In 1982 there were 251 verdicts equal to or exceeding $1 million. In 1984 the number had climbed to 401.

- In 1975 there were 5 medical malpractice claims for every 100 doctors in the U.S. By 1983 the rate had increased to 16 claims for every 100 doctors.

- The Annual average medical malpractice jury verdict has grown from $166,165 in 1974 to an estimated $954,888 in 1984.

- In 1974, it has been estimated that there were 1,579 civil product liability cases filed in federal courts. By 1984 this figure had reached 10,754.

- 28% of all local governments have some lawsuit pending against them as compared to 14% in 1982.

In addition, the reinsurance industry is concerned about developments in such areas of tort and insurance contract law which have made predictions of future loss trends difficult or impossible. They cite numerous example such as:

- PROGRESSION FROM A FAULT BASED SYSTEM FOR MANUFACTURERS TO ONE OF ALMOST ABSOLUTE LIABILITY.
- JOINT AND SEVERAL LIABILITY EXPANDED TO COMPENSATE PLAINTIFFS IRRESPECTIVE OF DEGREE OF FAULT.
- DISAPPEARANCE OF GOVERNMENTAL IMMUNITY.
- COURTS REWRITING INSURANCE CONTRACTS TO PROVIDE THE WIDEST POSSIBLE COVERAGE DESPITE CLEAR CONTRACT WORDING.

THE U.S. REINSURANCE INDUSTRY'S VIEW OF THE CIVIL JUSTICE SYSTEM HAS DRAMATICALLY IMPACTED THE AVAILABILITY OF REINSURANCE PROTECTION FOR PRIMARY COMPANIES. WHETHER OR NOT ONE ACCEPTS THE INDUSTRY'S VIEWS AND FEARS OF THE TRENDS IN THE CIVIL JUSTICE SYSTEM MAKES LITTLE DIFFERENCE. THE CARRIERS WHICH MUST PUT THEIR CAPITAL ON THE LINE ARE UNWILLING TO DO SO FOR MANY RISKS AND THIS IS THE REALITY OF THE SITUATION.

OTHER FACTORS

(1) HISTORICALLY, REINSURANCE TRANSACTIONS HAVE BEEN CONDUCTED AS AN AGREEMENT BETWEEN GENTLEMEN HENCE THERE EXISTED A GOOD DEAL OF TRUST BETWEEN ASSUMING AND CEDING COMPANIES AND RETROCESSIONAIRES. OVER

TIME, THIS MUTUAL TRUST HAS BEEN DISAPPEARING FOR A VARIETY OF REASONS, INCLUDING A NUMBER OF INSURANCE AND REINSURANCE FRAUD SCHEMES WHICH RESULTED IN SUBSTANTIAL LOSSES TO PRIMARY COMPANIES AND THEIR REINSURERS. MANY OF THESE SCHEMES WERE ACCOMPLISHED BECAUSE OF THE LACK OF VERIFICATION PROCEDURES AND CONTROLS BY THE VARIOUS PARTIES INVOLVED.

AS A RESULT OF THIS EXPERIENCE AND A NUMBER OF INTERNAL AND EXTERNAL FACTORS, UNDERWRITING HAS BECOME MUCH MORE CAREFUL OF THE TYPE AND NATURE OF BUSINESS IT WILL REINSURE, AS WELL AS THE COMPANIES IT WILL DO BUSINESS WITH. THIS ALSO IS HAVING AN IMPACT ON REINSURANCE AVAILABILITY.

(2) AS WAS DISCUSSED EARLIER, THE FINANCIAL RESULTS OF REINSURERS HAVE BEEN ADVERSE AND HAVE NEGATIVELY AFFECTED POLICYHOLDERS SURPLUS. THIS FACT ALONE MEANS REINSURERS HAVE LESS ABILITY TO WRITE BUSINESS EVEN IF ALL OTHER FACTORS WERE POSITIVE.

(3) THE ADVERSE EXPERIENCE OF REINSURERS OVER THE LAST FEW YEARS WHICH IN PART WAS DUE TO RELAXED UNDERWRITING DISCIPLINE HAS FORCED MANY COMPANIES TO TIGHTEN UNDERWRITING STANDARDS AND PRICING PRACTICES. THIS MEANS THAT LESS BUSINESS WILL BE ACCEPTED AS MORE CONSERVATIVE UNDERWRITING POLICIES ARE EMPLOYED.

APPENDIX

TABLE 1

Reinsurance Transactions of U.S. Insurance Companies with Insurers Resident Abroad, 1978-84
(Millions of dollars)

Reinsurance Transactions in the U.S. Balance of Payments

	1978	1979	1980	1981	1982	1983r	1984p
Net U.S. receipts 1/	222.0	217.3	235.9	220.3	188.1	125.2	96.6
Net U.S. payments 2/	754.3	836.5	859.6	886.5	778.4	493.7	397.8

	A. Net premiums paid on reinsurance ceded abroad							B. Losses recovered from abroad on ceded reinsurance						
	1978	1979	1980	1981	1982	1983r	1984p	1978	1979	1980	1981	1982	1983r	1984p
All areas	1,567.0	1,818.6	1,896.7	2,188.6	2,100.4	2,165.6	2,393.9	812.7	982.1	1,037.1	1,302.1	1,322.0	1,671.9	1,996.1
Western Europe, total	942.2	1,038.1	1,054.4	1,112.3	1,066.9	1,186.3	1,229.8	548.1	611.1	621.9	795.1	820.9	1,015.8	1,181.9
European Communities (10)	818.4	906.5	932.8	996.2	912.9	927.9	1,032.1	505.5	511.5	557.3	618.3	691.5	853.6	968.1
United Kingdom	611.3	643.9	662.6	662.7	639.2	626.9	686.3	392.8	362.1	353.5	420.9	438.0	589.2	661.6
European Communities (6)	193.7	248.6	276.6	322.7	263.6	272.9	320.1	108.0	161.8	191.2	261.2	248.6	268.8	287.3
Switzerland	86.3	79.2	75.7	98.0	116.5	136.4	148.9	31.9	61.5	36.1	73.9	91.5	115.4	151.2
Other	37.5	55.8	46.7	32.0	37.5	44.8	48.8	30.7	38.9	30.5	48.9	37.9	46.8	62.6
Canada	58.4	56.3	56.0	71.8	66.3	91.9	127.1	37.8	29.2	37.8	38.4	48.0	68.7	84.5
Latin American Republics	31.6	28.0	40.7	64.3	33.8	23.1	31.6	14.2	13.1	19.8	33.5	23.9	38.9	44.1
Other Western Hemisphere	431.3	397.8	456.9	788.9	866.4	818.8	886.9	136.5	271.8	278.3	353.1	368.5	413.5	517.9
Bermuda	424.0	386.1	447.0	737.6	809.9	775.8	849.7	133.4	267.6	266.8	342.8	329.8	399.3	500.3
Japan	60.7	70.1	68.0	70.8	66.7	86.2	86.2	33.7	35.1	63.3	56.1	61.1	85.3	100.6
Other countries	33.8	37.4	39.5	39.3	27.3	37.3	38.1	23.3	33.0	-.3	30.9	23.3	51.9	67.1

	C. Net premiums received on reinsurance assumed from abroad							D. Losses paid abroad on assumed reinsurance						
	1978	1979	1980	1981	1982	1983r	1984p	1978	1979	1980	1981	1982	1983r	1984p
All areas	803.1	827.0	896.5	952.6	926.3	999.9	1,079.0	581.1	610.3	660.6	732.3	738.2	841.7	982.4
Western Europe, total	436.9	461.3	516.5	580.2	673.9	687.6	696.9	331.2	361.9	379.8	413.2	411.6	437.5	473.6
European Communities (10)	369.5	370.1	428.1	429.2	605.5	636.7	643.8	283.2	277.6	301.7	330.7	356.5	363.6	381.7
United Kingdom	208.7	203.9	230.0	236.0	351.7	223.2	318.1	185.7	168.2	185.1	190.1	188.6	176.8	183.5
European Communities (6)	156.5	140.8	183.4	181.2	192.0	198.4	289.4	116.2	106.8	111.6	128.8	151.2	133.1	117.6
Switzerland	48.5	93.2	68.0	60.5	35.5	23.3	27.6	36.2	60.0	50.1	42.6	31.8	19.8	12.5
Other	26.9	25.6	20.6	26.5	32.8	30.7	31.3	31.8	24.6	28.0	39.9	28.3	46.1	79.7
Canada	167.0	158.9	165.5	187.8	187.8	195.3	244.8	97.1	105.1	138.3	166.0	131.5	165.7	190.0
Latin American Republics	58.5	59.7	73.6	89.9	82.9	73.6	89.7	43.5	42.6	45.6	63.8	56.3	68.5	53.7
Other Western Hemisphere	23.7	35.4	35.8	26.8	36.7	28.7	29.9	39.8	29.2	38.6	23.6	29.1	63.0	136.3
Bermuda	19.8	28.0	30.1	20.0	30.3	33.1	24.1	35.3	22.7	23.4	19.9	17.8	54.8	113.2
Japan	36.8	35.9	39.0	42.3	43.1	57.2	52.1	13.1	15.1	18.3	22.8	25.9	26.8	26.8
Other countries	63.2	76.7	67.3	87.9	102.9	161.3	183.6	43.6	56.0	66.2	63.5	72.8	129.5	163.6

p Preliminary r Revised
1. Premiums received less losses paid. 2. Premiums paid less losses recovered.

Source: U.S. Department of Commerce, Bureau of Economic Analysis

TABLE 2

12/85

REINSURERS WITHDRAWING FROM THE MARKET
During 1984 and 1985

Company Name	Withdrawn from Business
United States Companies	
Allstate Insurance Company	Facultative
American Centennial Insurance Company	assumed reins 4/30/85
American Mutual Reinsurance Company	no new or renewal (3/85)
Atlas Assurance Co of America	assumed reins 6/12/85
Beacon Insurance Company	in rehabilitation
Canadian Union (US Branch)	in run-off 12/31/84
Centaur Insurance Company	writes only credit insurance
Cherokee Insurance Company	in rehabilitation
Christiania General Insurance Corp of NY	Facultative
Cologne Reinsurance Co of America	Property Facultative
Constellation Reinsurance Company	withdrew effective 7/1/85
CU Reinsurance Company	in run-off
Delta America Re Insurance Company	in liquidation
Dominion Ins Co of America	discontinued writing (7/85)
Eagle Star Insurance Co of America	assumed reins 11/01/84
Employers Ins of Wausau A Mutual Co	assumed reins 7/1/85
Folksamerica Reinsurance Company	Facultative
Gerling Global Reins Corp (US Branch)	casualty lines
Glacier General Assurance Company	in liquidation 11/12/85
Great American Insurance Company	reinsurance
Ideal Mutual Insurance Company	in liquidation
Insurance Corporation of Ireland (US Branch)	discontinued writing
London Guar & Acc Ins Co of NY	discontinued (9/85)
Metropolitan Reinsurance Company	facultative
Mission Reinsurance Company	in conservatorship
Mission Insurance Company	in conservatorship
Mission National Insurance Company	in conservatorship
Monarch Insurance Co of Ohio	assumed reins 4/17/85
New England Reinsurance Corp	closed 3 fac branches (5/85)
Ohio Reinsurance Corporation	withdrew in late 1984
Optimum Insurance Company	in rehabilitation
Ormond Reinsurance Company	in run-off
Philadelphia Manufacturers Mutual	merged Arkwright-Boston 09/84
Phoenix Assurance Company of NY	assumed reins (9/85)
PMA Reinsurance Corporation	facultative
Presido Insurance Company	in conservatorship
Public Service Mutual	reins assumed (11/85)
Puritan Insurance Company	in run-off
Ranger Insurance Company	reins assumed (7/1/85)
Republic Insurance Company	reins assumed (7/1/85)
Rochdale Insurance Company	in run-off
Sentry Reinsurance (Sentry A Mutual Co)	reinsurance
Skandia America Reinsurance Corporation	closed two facultative offices
Southeastern Fire Ins Co	discontinued (6/30/85)

TABLE 2 (cont.)

12/85

REINSURERS WITHDRAWING FROM THE MARKET
During 1984 and 1985

Company Name	Withdrawn from Business
United States Companies (Continued)	
Taisho Marine & Fire Ins Co (US Branch)	assumed reins (12/31/85)
Transit Casualty Company	in liquidation (1985)
Transportation Mutual Insurance Company	suspended by Pa Insurance Dept
Unigard Mutual Insurance Company	reins (merged w/ Hanseco)
Union Indemnity Ins Co of New York	in liquidation
United Americas Insurance	in run-off
Universal Reinsurance Corporation	surplus enhancement order (NJ)
New York Insurance Exchange	
Anex Syndicate, Inc	non-parent business 10/01/84
Burt Syndicate, Inc	discontinued writing (1984)
Candon Syndicate, Inc	discontinued writing (12/85)
Chubb Syndicate, Inc	discontinued writing (3/85)
Essex Syndicate, Inc	discontinued writing (10/85)
First New York Syndicate Corp	not writing (early 1985)
First State Syndicate, Inc	discontinued writing (06/85)
Heartland Syndicate, Inc	discontinued writing (12/85)
John Street Syndicate, Inc	discontinued writing (10/85)
KCC New York Syndicate Corp	discontinued writing (5/84)
North Star Syndicate Inc	discontinued writing (2/85)
Pine Top Syndicate, Inc	discontinued fac casualty (84)
Polaris Syndicate Inc	discontinued writing (2/85)
Pruco Syndicate, Inc	discontinued writing (10/85)
Realex Group N.V.	discontinued writing (mid-84)
Republic Western Syndicate, Inc	discontinued writing (10/85)
Sentry Syndicate, Inc	discontinued writing (12/85)
Syndicate of Wall Street Investors	facultative (04/84)
U.S. Risk Inc	discontinued writing (mid-84)
William Street Syndicate Inc	discontinued writings (4/85)
The 1792 Company	discontinued fac casualty (84)
Bermuda Companies	
Ancon Insurance Company , SA	in run-off (10/01/84)
Cambridge Reinsurance Limited	in liquidation (4/85)
Horizon Insurance Company	non-parent business
Insco Limited	in run-off (11/16/84)
Mentor Insurance Limited	in liquidation (6/21/85)

TABLE 2 (cont.)

12/85

REINSURERS WITHDRAWING FROM THE MARKET
During 1984 and 1985

Company Name	Withdrawn from Business
Canada	
Northumberland General Ins Co	in liquidation (07/25/85)
Toronto General Insurance Company	US business (04/85)
Saskatchewan Government Ins (SGI)	withdrew assumed reins (12/85)
Denmark	
Top International	discontinued reins (early 85)
French Companies	
Mead Reassurance	in run-off
Germany	
Hannover Rueck AG	international property fac
Herold Rueck AG	in run-off
United Kingdom Companies	
Ancon Insurance Company (UK) Ltd	in run-off (10/01/84)
British National Insurance Company Ltd	reinsurance (run-off)
North Atlantic Insurance Company Ltd	merged into British National

Senator **Metzenbaum**. Thank you.

Mr. **Levinson**. Mr. Chairman, Senator Biden, Senator Heflin, I am David Levinson, Insurance Commissioner of the State of Delaware, and the views which I am presenting today are my own and are a minority view among State commissioners, possibly a minority of one.

We can all agree, however, that the insurance industry faces serious problems today, many of which have little to do with proper regulation of the insurance industry—the uninsurability of certain risks which, in fact, are societal problems; uncertainties, real or perceived, within the civil justice system; rapidly fluctuating interest rates leading to the cyclical nature of insurance underwriting. None of these can be significantly affected by insurance regulators.

The major insurance issue which we must confront is how we are going to spread risks throughout our society and which risks we are going to spread. This problem is probably most clearly illustrated in the area of health insurance.

We as a society are substituting health insurance premiums for taxes. The cost of the medically indigent is often picked up by medical providers who, in turn, pass the cost along to premium-paying policyholders. This hidden tax is regressive. The financial ability of the policyholder to pay the hidden tax is never considered.

Indeed, the healthy wealthy, who are often self-insured, pay nothing at all. This hidden tax is paid for by health insurance policyholders, collected by insurance companies, and never approved, assessed, debated or monitored by any elected official or legislative group, and there is little, if anything, that an insurance regulator can do about that.

However, we are here today to discuss the limited question of the adequacy of State regulation in those areas where society's intent is clear and whether the Federal Government can do the job better.

Let me make clear at the outset by own bias. I have no ideological preference for either State or Federal regulation. I am an orthodox pragmatist. I would like to say that State regulation by and large works and that most regulatory functions are performed efficiently most of the time at the State level. Licensing of agents, consumer and unfair claims investigations, and various educational functions are visible examples.

These functions are clearly more appropriately managed at the State level because of the local nature of the activity involved. Moreover, any failure to perform these functions effectively at a State level penalizes only the residents of the individual State, and they possess the political power to replace those who manage their affairs.

There are, however, three problem areas to which I believe a national solution, although not necessarily a Federal solution, is appropriate. First, there is the problem of dealing with interstate fraud. Let me give you an example.

Recently, Delaware's insurance department received calls regarding the operation of a company which called itself North American Insurance Company, or NAIC, a name which my colleagues in the National Association of Insurance Commissioners did not particularly appreciate. [Laughter.]

This company alleged inaccurately that it was a Delaware domestic insurer. Delaware issued a cease and desist order prohibiting the company from alleging that it was authorized by the State of Delaware to sell insurance, an order which the company promptly ignored.

The principles of the company were located in Texas. Texas moved in the Texas courts to stop the company from selling insurance in Texas. The principles of the company simply moved to Atlanta, Georgia, changed the name of the sham insurer, and they continue to do business today.

We fully informed the Federal Bureau of Investigation, which has indicated no particular interest in pursuing the matter.

Monopolistic behavior by insurers, particularly in small States, is a second problem which some States cannot solve without assistance. As you know, availability of liability insurance rose to the level of a national crisis during the past 2 years. Insurers moved in concert to radically raise rates.

While regulators of large States have the market ability to provide a countervailing force through the threat of expulsion, regulators of small States are virtually helpless in the face of concerted action by the industry.The threat of a small State like Delaware to expel a multi-national giant has all the effect of a B-B gun on an elephant.

I think it is important to note that both the control of interstate fraud and monopolistic behavior are systemic problems. If all State regulators did their jobs perfectly, these problems would continue to exist. Only by creating an entity with the power to act in all States can these problems be solved.

The third problem for which a solution is required is of even greater significance and much greater complexity. That is the problem of guaranteeing policyholders that the companies which insure them are and remain solvent, able to pay claims when those claims come due.

The organization of the insurance industry is extremely complex. It includes licensed insurers, reinsurers, unlicensed but admitted excess and surplus lines insurers, non-admitted insurers, domestic, foreign and alien insurers, and, massively increasing the organizational complexity of the insurance industry, it now includes the potential proliferation of risk retention groups.

No individual State regulator of the insurance industry can possibly have full knowledge of the financial stability of every company which insures and reinsures the citizens of his State.

Instead, the State regulator must rely on other States 'regulation of their domestic companies. If each State had guaranty associations covering all lines and if each State regulator did his job perfectly, State regulation of solvency would work perfectly.

However, 13 States have no life and guaranty health associations; and if an insurance company can find a weak link in the chain of insurance regulation, the system begins to break down. And those weak links arise from time-to-time for the same reasons that any system can fail, including a Federal system—incompetence, indifference, lack of resources, or downright corruption.

One further complicating factor which impacts on solvency is control over the rates charged for coverage. Insurance commissioners are either elected or appointed by a governor who is elected, and elected officials naturally want to see rates kept low. But if rates are too low, not only is solvency threatened, but the danger exists that companies will subsidize losses in one State with excess profits in another.

I suggested at the outset of my remarks that these three problems—interstate fraud, monopolistic behavior in small States, and solvency regulation—require a national solution. But a national solution is not necessarily a Federal solution.

Before repealing McCarran-Ferguson and opening the entire area of insurance regulation to a host of new problems, it seems to me that there is another solution that merits consideration.

An organization already exists that has a virtual monopoly of regulatory expertise of the insurance industry. It understands the problems of interstate insurance fraud, some of its members understand the problem of monopolistic behavior in small States, and it has a rapidly growing data base relating to financial solvency of insurers.

That organization is the National Association of Insurance Commissioners.

As an organization, the National Association of Insurance Commissioners has the ability to solve each of the problems that I have raised today. What it lacks is the statutory authority, the resources, and perhaps the political will.

My recommendation today is that this committee consider legislation giving to the NAIC the necessary authority and resources to solve the problems of interstate insurance fraud, monopolistic behavior, and solvency oversight in States that fail to meet their individual responsibilities.

I recognize that the NAIC has limitations inherent in the manner in which insurance commissioners are selected. Eighty percent of them serve at the pleasure of their governor and the average tenure of appointed commissioners is less than 2 years.

However, the current leadership of the NAIC is here with us today. President Edward Muhl of Maryland and Vice President John Washburn of Illinois are each strong, knowledgeable, dedicated regulators in whom I, for one, have complete confidence, and I believe that the entire membership and staff of the NAIC would rise to the challenge of enhanced authority and responsibility.

I would like to thank you, Mr. Chairman, members of the committee, for giving me the opportunity to present my views today on these important issues affecting all of our citizens.

[Response to questions:]

State of Delaware

DAVID N. LEVINSON
INSURANCE COMMISSIONER

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DOVER, DELAWARE 19901
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Department of Insurance

JUDICIARY COMMITTEE
87 MAR 31 AM 9 45

March 26, 1987

The Honorable Joseph R. Biden, Jr.
United States Senator
UNITED STATES SENATE
489 Russell Senate Office Bldg.
Washington, DC. 20510

Dear Senator Biden:

I appreciate the opportunity to respond to the additional questions you raised in your recent letter regarding the insurance industry.

1. There is without question a present crisis in the reinsurance market. For several years several leading reinsurers have had unusually high loss ratios. Recent action by California in ordering the liquidation of Mission Insurance Company is expected to have a ripple effect throughout the industry, as the effect of uncollectible reinsurance is absorbed into the financial statements of the companies which Mission reinsures.

The problem in obtaining reinsurance has directly affected the property and casualty direct insurance market. Direct insurers, unable to "lay off" high dollar layers of coverage to reinsurers, have refused, indeed have been unable, to underwrite many risks. The result has been that insureds cannot find sufficient coverage. The practice of some reinsurers in the past to assume 100% of the risk underwritten has fueled, to some extent, the present crisis. Because some direct insurers were ceding all of the risk, they failed to audit the business which they and their Managing General Agents were underwriting. Many reinsurers who assumed liabilities under these circumstances are now denying payment, alleging that the failure of the direct writer to adequately underwrite constitutes fraud.

2. You are correct in stating that much of the international insurance market is unregulated. However, recent changes in the required NAIC reporting requirements, and

adoption of the model NAIC reinsurance law, are significant steps towards controlling the "off shore" company problems. The NAIC "convention blank", which must be filed in the domiciliary state now requires insurers to take a penalty on their statutory statement if they have ceded insurance to "unauthorized (improperly regulated) reinsurers". "Unauthorized reinsurers" are required under the NAIC model law (adopted by Delaware in June 1985) to have letters of credit with U.S. banks, or securities on deposit, before those whom they have reinsured may take credit against liabilities for reinsurance ceded. I would like to add that not all foreign reinsurers are inadequately regulated. The London and German markets are examples of good foreign regulation.

3. The effect of a repeal of McCarren-Ferguson on reinsurance would be difficult to quantify. It is possible that subscription treaties, where several reinsurers agree to assume a percentage of the reinsured business, could be construed to be a combination in restraint of trade. Ten years ago, most reinsurance was done through the London market. Today a significant percent of reinsurance is done through U.S. based companies. However, repeal of McCarran-Ferguson could simply ship this business offshore once again, as the repeal would not affect foreign companies. Superimposed on this scenario is the fragmentation of the reinsurance industry. Probably no U.S. insurer controls more than 10% of the reinsurance market. Most reinsurers are not large enough to assume total risks by themselves and must combine to provide adequate treaties.

4. As I suggested in my testimony, I do not believe that the repeal of McCarran-Ferguson addresses any of the very real national insurance issues. The NAIC is moving in the right direction. In my opinion legislation should be drafted to permit the NAIC to require that any company insuring or reinsuring any U.S. citizen file an annual Convention Blank with the NAIC and pay an appropriate fee. This legislation should empower the NAIC to itself "cross state lines" in dealing with the problems of interstate fraud and solvency oversight.

The purpose of antitrust legislation is to create a balance of economic power. The insurance industry needs the exemption for a host of reasons (note the number of exceptions proposed in any repeal legislation). An appropriate balance of power can be achieved more effectively by increasing the power of the insurance regulatory apparatus rather than depriving the insurance industry of the cooperative functions that all parties agree are necessary.

Thank you for the opportunity to discuss these issues with you. If I can be of further assistance please call upon me.

Sincerely,

Dave

David N. Levinson
Insurance Commissioner

DNL/CSM/sd

Senator **Metzenbaum**. Mr. Halperin, we are happy to hear from you, sir.

Mr. **Halperin**. Mr. Chairman, I will forgo the reading of the statement which I submitted and ask that it be entered into the record. That is for our mutual advantage.

I would like to comment on what was stated here earlier today. First of all, from my discussions with various members of Congress—and I know, sir, that you have had a longstanding interest in this, but certainly a major motivation for a wider interest in this issue has been the situation which we face in the area of affordability and availability across the Nation.

I would have to go along with what Senator Hatch stated at the commencement of the hearings that, in fact, the outright repeal of the antitrust provisions of McCarran-Ferguson would, in fact, I believe, not in any way help to deal with that problem.

It is probably because of overly aggressive competition, not taking into full account the underwriting realities and rather looking towards investments in the late 1970s and early 1980s that led to the crisis that we have seen over the last few years.

Now that the market is easing up, we are beginning to see the greater availability and reduction in rates. This has been in some States accelerated by certain legislative action, such as we took in New York State last year. So I would simply say that to the extent that the availability and affordability of insurance is a motivation that that factor be very carefully looked at.

There are two other main areas that should be of interest to everyone who is concerned about the way that the insurance industry serves the public. Those areas are solvency and consumer protection.

I simply state that while from time to time there are embarrassments both at the State level when it comes to solvency in the insurance industry and at the Federal level when it comes to solvency at banks, the State has done its job, as well as the Federal Government has done its in the area of banking, and that the NAIC, in conjunction with, of course, the members of the NAIC acting individually and as States, has put into place mechanisms that will be able to do this job even better, and that we at the legislative level will work in conjunction and try to support those efforts.

Finally, when it comes to the area of consumer protection, I feel that this is particularly where the States stand out in being able to serve the public. Just yesterday, I had a member of my staff call four different insurance departments and within 3 rings the phone was picked up. When we called the Internal Revenue Service, it took 10 rings. [Laughter.]

While that is a fairly simplistic example, I think it is indicative of an overall situation in trying to deal with larger Federal bureaucracies as compared with State agencies, which I have found to be much more responsive to problems that are faced by individuals.

I have been listening very carefully to the testimony and I found it very interesting comparing the State of New York with some of the smaller States which do seem to have problems that we do not have in New York, perhaps because no company is willing to give up New York—well, I would not say none, but few are willing to give up New York as part of their market.

But we have been aggressive. We have demanded information and we have gotten it, and last year when we were grappling with what we could do to ease up the market situation in the area of tort law changes and flex rating, which is now being looked at around the country as at least a partial solution to the problem, we demanded and received information as to what the underwriting realities were.

And I say "realities" advisedly because sometimes I wonder how realistic underwriting practices are. It is not easy to get this information, but on the other hand it is also because of the difficulty in anyone coming up with realistic information.

We were discussing here earlier, various people who testified, the need for regulation of rates and the fact that other industries are subject to antitrust in order to prevent them from price-fixing.

Well, the whole idea of the regulation of insurance is, in fact, to fix prices; that the States do in one form or another, some perhaps better than others, attempt to regulate the prices.

If that is, in fact, the main motivation of antitrust legislation, I believe that is being done fairly adequately by the States and that the only way to really prevent the swings in the industry would be to prevent the reduction of rates, something which I do not think would be very popular among the public at the time that that is being proposed.

Finally, to sum up, I would suggest that to the extent that perhaps some greater regulation is required that you look at it from that perspective and not take the shotgun approach, because I think you will have many unintended effects that have already been alluded to.

And I would say one more thing, that when you opened up your statement, Mr. Chairman, you said that it was not your intent to undermine the State's right to regulate insurance. I think that the way that the bill is presently drafted, it would do just that, and that at the very least it should be amended to leave within it the provisions which relate to the State's right to regulate insurance.

[Statement follows:]

STATEMENT OF NEW YORK STATE SENATOR DONALD M. HALPERIN, CHAIRMAN OF THE FEDERAL-STATE RELATIONS COMMITTEE AND PRESIDENT-ELECT OF THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS BEFORE A HEARING OF THE UNITED STATES SENATE COMMITTEE ON JUDICIARY, FEBRUARY 18, 1987

Chairman Biden, members of the Senate Judiciary Committee, The National Conference of Insurance Legislators (COIL) welcomes the opportunity to make this statement today and looks forward to continuing a substantive dialogue on the merits of McCarran-Ferguson.

On behalf of the Conference, I am here to speak against repeal of McCarran-Ferguson.

COIL believes repeal would represent a profound error of national regulatory and economic policy and would indeed be counter-productive.

The question of McCarran-Ferguson repeal must be considered in the light of two consequences. The first is the elimination of the long established pre-eminence of the states in the regulation of insurance. The second is the application of the anti-trust laws on the business of insurance.

COIL believes the down grading of the state role would represent the greatest disruption in state-federal relation in more than a century.

COIL believes that replacement of McCarran-Ferguson with the Federal Anti-trust laws could bring about price wars that no state government, no federal agency and no United Nations peacekeeping force could control.

A resolution adopted unanimously at the Annual Meeting of the Conference in Nashville, Tennessee, on November 15, 1986, reaffirmed the Conference's strong support of McCarran-Ferguson. Like myself, state legislators who voted for that resolution chair or serve on committees responsible for insurance legislation within their respective states.

In discussions with the members of Congress, COIL members have come away with the distint impression that most of the sudden interest in federal involvement in insurance regulation grew out of the crisis in commercial liability insurance that occurred in 1985 and 1986.

As a legislator I can well understand how the occurrences of the last several years in the property casualty segment of the insurance industry have generated tremendous interest among Members of Congress. Constituent outcry is a powerful incentive for speedy action. At the same time, we know that all change is not progress and I suggest that we look into the causes of the recent crisis in order to understand where the solution might lie. Those familiar with the insurance industry will tell you that it is cyclical in nature. The good news of low rates in the late Seventies became the bad news of sharply increased rates and disruptions in coverage in the mid Eighties. Could government have prevented it? One way would have been to have stopped insurers from lowering rates as they did. But would the federal government been any more willing to do that than the states were. I think not. Such action would have been difficult in any regulatory environment, but in the deregulatory climate of Washington in recent years there is just no way it would have happened.

That crisis sprung from a confluence of different causes but one thing is sure; its immediate cause was the excessive price competion among insurers.

Chairman Biden, repeal of McCarran-Ferguson and imposition of federal anti-trust statutes would not prevent a recurrence of price wars. It could encourage them. Repeal of the statute and the limited anti-trust exemption would prevent the sharing of loss date, the use of advisory and bureau rates, all things that lend stability, discipline and credibility to insurance rate making.

During the years of cash flow underwriting that preceded the crisis, insurers at least knew that their rates were lower than they should have been, based on industry-wide experience. Without shared data, excessive competition could well become blind competition, especially for small insurers with limited market share and, therefore, limited loss data.

Under the anti-trust laws companies would be barred from use of shared data. Some could prudently withdraw from business, or might remain and could suffer great losses. In either event, the result would be a shake out of many smaller companies, reduced capacity, unavailability and inevitable price increases in a concentrated market — all perfectly permissible under the anti-trust laws. The over-concentration and diminished capacity would invite foreign competition.

To prevent these adverse consequences Congress would have to to in totally the opposite direction. It would have to establish federal insurance rate regulation on the public utility model. I do not believe the Congress or its constituents are prepared to go that far. The momentum in the states and in Washington has been and continues to be in the direction of de-regulation.

None of this is to say that competition does not have its place. It certainly does. Under McCarran-Ferguson, we have seen the development of a uniquely competitive system, underwriting cycles and instances of over-competion notwithstanding. The use of shared data has enabled the entire industry to benefit from unprecedented economies of scale. It has allowed for ease of entry into business and enabled small companies to remain competitive. It has enhanced insurance capacity. The results speak for themselves. There are now some 5000 insurance underwriting companies (3000 property and casualty and 2000 life and health insurers) in the U.S. market. They compete for business on the basis of price, coverage and service.

That kind of competitive environment compares, I respectfully submit, most favorably with other major U.S. industries operating under federal and anti-trust laws. It compares most favorably with, for example, the American automobile manufacturing industry, where now there are only three major domestic U.S. manufacturers and where competition from overseas is most formidable. Under McCarran-Ferguson, U.S. insurers continue to enjoy the larger share of the domestic market.

There are two areas other than affordability and availability that should be of concern to this committee: solvency and consumer services. While I do not suggest that the states have batted one thousand in these two areas, I do feel quite comfortable in saying that we have done a credible job, one which I believe would compare favorably with that of the federal government.

Under McCarran-Ferguson, regulation has been aggressive. State insurance departments and agencies of state governments working with them have actively administered and enforced state insurance laws and regulations. They have brought disciplinary actions against agents and companies which have resulted in suspension or revocation of licenses. They have obtained orders to end unlawful practices and levied heavy fines. They have helped consumers who had legitimate complaints concerning policy language and claim payments.

The transfer of those functions to federal agencies cannot be accomplished without serious and, I submit, unnecessary disruptions, with no guarantee that they would improve performance. Mr. Chairman, I believe my constituents and yours would much rather deal with their state insurance departments or most other state agencies that with their federal counterparts. Ask why and they will tell you the answer is service. Just yesterday we called four State Insurance Departments and the phone was answered in one to three rings. When we called the U.S. Internal Revenue Service we waited for more than ten rings.

Most important, under McCarran-Ferguson, the states have monitored the solvency of insurers with effective results. The states have spotted company failures before they happened, thus reducing the number and severity. The number of failures of state regulated insurers compares most favorably against the failure of banks regulated under federal regulation. While the states have unfortunately sustained their fair share of bruises, so have different federal agencies.

As legislators, we clearly understand the oversight role of this Committee, the Senate, and the Congress. We will work to overcome problems which you may identify. We know that we must try to check the excessive competition shortages and price fluctuations to the extent we can, even though insurance prices and availability are the product of forces like changes in the rate of inflation, interest, accident, illness and death. Those changes are influenced by forces outside the insurance system and they will continue to change no matter how insurance is regulated or who regulates it.

At the same time, Mr. Chairman, we know that state regulation has not been perfect. Our conference has a well documented record of objectivity regarding the performance of states in regulating insurance. The Conference task force report entitled: "Risk, Reality, and Reason in Financial Services De-regulation" published in 1983 and a follow up report entitled "Closing the Regulatory Time Warp," published in 1984, identified shortcomings in the solvency monitoring process and the need for electronic enhancements, many of which are now in place. Last year, an interim report of a COIL Task Force disclosed the candid perceptions of state legislators and insurance department personnel on the effectiveness or ineffectiveness of specific state tort, insurance and regulatory reforms on the availability and affordability of liability insurance.

Mr. Chairman, we in COIL believe insurance buyers have been well served by a regulatory system that has spurred efficiencies, and competition among strong companies, and one that has benefited from the oversight of legislators -- state and federal.

Senator **Metzenbaum**. Thank you, Senator Halperin.

One of the concerns that I have relates to the question of the adequacy of insurance regulation at the State level. I say that notwithstanding the fact that I have said two or three times already today that I am not advocating Federal regulation.

But it has been a longtime source of unhappiness to me that every insurance commissioner I ever knew, every one I ever knew, was later employed by an insurance company; and many of them had come from an insurance company prior to the commissioner position.

When I served in the legislature, nobody served on an insurance committee that did not have a business tie with the insurance industry. Nobody wanted to, and those who were in the industry, whether they were lawyers for the insurance companies or whether they were insurance agents or whether they were claim agents or whatever—they were always the ones who served on the insurance committees, and I served in both the House and the Senate in the Ohio Legislature.

My question to you, Mr. Muhl, is, is it not the fact that in many cases the insurance commissioner or superintendent is not in a position to provide any regulation because all he or she does is accept a filing of the rate with the commission?

Mr. **Muhl**. That is absolutely not true.

Senator **Metzenbaum**. In no States?

Mr. **Muhl**. There may be States——

Senator **Metzenbaum**. How about Ohio, sir?

Mr. **Muhl**. I have no idea.

Senator **Metzenbaum**. Well, then, obviously, it is not absolutely not true.

Mr. **Muhl**. All right. First, Senator——

Senator **Metzenbaum**. Give me the facts. What do you know? How many States permit a filing and how many States give the superintendent some authority to do something about it?

Mr. **Muhl**. Well, first, if you are referring to a prior approval mechanism versus an open competition mechanism, I think there are about 32 States that have some sort of an open competition forum where it is a file-and-use or use-and-file State.

If that is what you are referring to, versus a prior approval, then, yes, there are 32 States that have an open competition, including my State.

Senator **Metzenbaum**. Thirty-two States have use-and-file, is that what you are saying?

Mr. **Muhl**. Yes, there are about 32 States that have some form of open competition. I am not sure exactly of the number that have a use-and-file versus a file-and-use.

Senator **Metzenbaum**. How does that provide for competition? If the xyz company starts to use the rate, charge the rate and then files it, how does that provide competition?

Mr. **Muhl**. Well, if you believe in competition, which I think you do, as we all do, the competitive forces will work to find that lowest level of rates, and we found in my State that open competition has found the lowest level because the competing forces come to play and they act as a very good regulator of those rates to the extent that they do find the lowest premium possible for the consumer.

Senator **Metzenbaum**. You know, one of the concerns, Mr. Muhl, is that there is no competition; that you have to beg your insurance carrier to write your policy and you are afraid he will cancel on you.

I myself, a United States Senator, am constantly concerned that if I put in a claim or if I raise some question as to why the rate was changed that the whole policy is going to be canceled.

Now, you say there is competition. I do not know of ten different insurance companies coming to seek my business, nor do I know of ten different companies necessarily willing to write my business, and I do not have that much exposure; I just do my work as a Senator.

Mr. **Muhl**. We have a unique system in my State, Senator. We have a modified open competition forum which allows the competitive forces to work when competition is there and does exist.

If we make that determination, and we have most recently in several areas and lines of insurance, that competition is not as great as we would hope it would be or would like to see it, we have the authority to revert that whole system back to a prior approval until such time as the competitive forces come back into the marketplace. It is a very unique system and one that has been very beneficial.

Senator **Metzenbaum**. Mr. Levinson indicated that the NAIC is a very effective organization. Can you give us the facts and figures with respect to those States where you can just use and file, those States where you have to get prior approval before you can put a rate into effect, and what authority the various States have as pertains to approving or disapproving not only the rates but the policies as well, so that the policies may be understood by an average human being?

Mr. **Muhl**. We have that available. We would be more than pleased to supply it to you. We have also supplied that same or similar information to your counterparts both in the House as well as in some of the Senate committees.

But I think Director Washburn would like to respond as well.

Senator **Metzenbaum**. Mr. Washburn?

Mr. **Washburn**. If I may, Senator, by the way I did not come from the industry. I worked for the governor as his legislative assistant for 3 years, and prior to that I was on the State senate staff.

Senator **Metzenbaum**. You are rather unusual in your field. From all the information I can find, I find that most, if they did not come from the industry to the regulatory body, they wind up going to the industry.

Mr. **Levinson**. Senator, I was a real estate developer and I never had anything to do with the insurance industry at all.

Senator **Metzenbaum**. A 1979 GAO report found that insurance regulation is not characterized by an arm's length relationship between the regulators and the regulated. For example, GAO found that about half of the State insurance commissioners were previously employed by the insurance industry and roughly the same proportion joined the industry after leaving office.

So there is factual data, and I am not pointing at you, Mr. Levinson, or Mr. Washburn or Mr. Muhl, or anybody specifically. I am talking about these facts. Half came from the industry and half went into the industry.

Mr. WASHBURN. And if I am not incorrect, that happens with the Federal regulatory agencies, too.

But to answer your question on competition, in Illinois they do not even file rates on the majority of——

Senator METZENBAUM. In Illinois you do not even file rates?

Mr. WASHBURN. We do not even have a rating law in Illinois, and what that does is promote competition. We have 1,400 companies out there that can write the policies that they wish to write and if they see a rate that they would like, they do not have to wait for our approval to do it; they can just charge that rate.

Usually, for competitive purposes you are going to have to charge a lower rate to move into a market, and if you see a company whose rate you think is high enough that you can compete with them at a lower rate, there is really nothing to stop you.

Senator METZENBAUM. Mr. Washburn, I think we have to make a distinction. When you talk about writing for General Motors or writing for General Dynamics or General Electric or that kind of business, there is an element of competition where the insurance industry is involved.

But I am not talking about that. I am talking about the competition for property and casualty insurance, for bodily injury insurance, for auto and theft insurance. I am talking about the average person trying to buy insurance, and I think we ought to relate our discussion to that.

Mr. WASHBURN. The average Main Street policy for the mom-and-pop business—there are probably 100 or 200 firms that fight for Main Street business, and they are fighting with not only independent agent-type operations, but direct agents; as an example, State Farm. There are companies that will compete for that business.

What happened over the last several years was in very difficult lines, just about everybody moved out and nobody wanted the line, period, and the question is whether they will come back.

But I am not quite sure that for the majority of businesses—although the price is more expensive than they had before, I think you will see that this year there is going to be competition out there for that business.

Senator METZENBAUM. Mr. Washburn, my time has expired.

Senator Grassley.

Senator GRASSLEY. Mr. Chairman, I have no questions for this panel.

Senator METZENBAUM. Senator Heflin.

Senator HEFLIN. Mr. Muhl, what have the States done to address the insurance market problem since the beginning of this liability insurance crisis?

Mr. MUHL. Well, it has been handled in varying and many ways, which I guess is one of the ideal situations with State regulation. For an example, in my State we had some problems, and in some cases some very severe problems, but they may not have been the same degree of severity of the problems experienced in Illinois or California or New York, or elsewhere.

We were able to find solutions in my State, as my counterparts in other jurisdictions found solutions that best fit their citizens in those jurisdictions. We have formed market assistance programs where, in fact, we have matched buyer and seller, if you will, to locate where the existence of certain coverages would be located.

The National Association of Insurance Commissioners, for an example, as well, aided and assisted in putting together a malpractice program for the nurse midwives throughout the United States.

So we have been actively on the front line handling concerns and problems, finding solutions, and we have found many of them for many of our insurance-buying public in our jurisdictions.

Senator HEFLIN. Mr. Levinson, do you have any comments on that?

Mr. LEVINSON. Yes. In our State, sir, we moved very quickly in three different areas. The legislature immediately passed legislation authorizing the commissioner to ban mid-term cancellations and extend termination dates in critical areas, which I did.

Once that was done, we moved with the industry to create a MAP, or a market assistance plan, as Commissioner Muhl has pointed out. That plan has operated very effectively and every single application in our State for liability insurance that has been made to the MAP has, in fact, been placed through the MAP, which works closely with our department.

But to prevent future problems, our State has also funded a study of what I call a liability lake, a pooling of pools, so that those risks in our small State which have a substantially better loss ratio than national averages but insufficient numbers of insureds to have actuarial credibility, can join together in a multi-line pool which will cover, I anticipate, municipalities, counties, conceivably State government itself, day care centers and a number of others who have been charged unmercifully in our State and yet have very low loss ratios; indeed, in the case of nurse midwives, zero, and in the case of day care centers, 5 percent.

They will be able to join together not only to guarantee future availability—there is availability now—but to get a rate, to get a price, more appropriate to the actual experience in our State.

Senator HEFLIN. I am somewhat intrigued with your idea of the National Association of Insurance Commissioners being given certain authority. I see all sorts of impediments in connection with it.

Do you know of any instance in which some similar association, not in insurance but elsewhere, has ever been designated a Federal authority? I do not know of any association that has been so designated. If we have some way to keep it from being a Federal bureaucracy, that might well be an approach, but do you know of any examples?

Mr. LEVINSON. I will provide you with some, Senator. I asked a law professor down here in Washington to research it for me. He assured me last night that there are several precedents for granting authority to quasi-public/quasi-private agencies, and I will be happy to provide you with a memorandum on that.

However, even if there is no precedent, you know, hard times require new solutions and it seems to me that we have been asking the wrong question. We have consistently been asking the question for 40 years now, Federal versus State.

The real issue is identifying the problem and figuring how we can use current resources to solve that problem without opening a Pandora's box of new problems, unknown problems, and also creating new bureaucracies and spending a lot of money.

I calculate that for something like a one-thousandth of one percent premium tax, the NAIC could accomplish what I envision. And that, of course, is so negligible as not to be a blip on an insurance company's balance sheet.

Senator **Heflin**. Thank you. That is all.

Senator **Metzenbaum**. Thank you, Senator Heflin.

Apropos your suggestion, Mr. Levinson, I would like to ask Mr. Muhl, did your predecessor as commissioner leave his position to join an insurance company?

Mr. **Muhl**. Eventually, he wound up with an insurance company, yes; not immediately, but subsequent.

Senator **Metzenbaum**. Is it not the case that he had been responsible for issuing a license to that very company and that the company subsequently went bankrupt?

Mr. **Muhl**. That is correct, and it is true also, Senator——

Senator **Metzenbaum**. I have some trouble with your idea. I guess insurance commissioners and the NAIC have their own problems in keeping themselves separate from the industry, as indicated by Mr. Muhl's predecessor.

Mr. **Levinson**. Sir, I would respectfully suggest that the activity that you just objected to—and I do not know the facts and I certainly make no judgment on them—did not in any way stem from the gentleman's position with the NAIC or his activities with the NAIC.

It referred to his activity as an individual commissioner, and I suggest to you, sir, that appropriate behavior or inappropriate behavior is not limited to any given level of government; anything can occur anywhere.

But what I truly believe, having spent 2 years now in the company of my fellow commissioners—and I do not come from the industry in any way—is that they are, by and large, dedicated folks, particularly the people who rise to the level of office in the NAIC, and that if the NAIC had the responsibilities and the authority to act in the way I have suggested, the plenary of the NAIC, which is all of the commissioners, and the executive committee, which is 15 of us, would take a much more active role and that the very political internal nature of the NAIC would change almost immediately to assure the appropriate behavior at that level.

Senator **Metzenbaum**. Well, Mr. Muhl, let me then ask you another question along that line. The GAO also found that the meetings of the NAIC were dominated by industry representatives and that registration fees from company representatives actually pay the administrative expenses of the meetings.

Is that still true?

Mr. **Muhl**. The fees actually go toward, yes, paying for some of the administrative fees, but there are also assessments of insurance departments and what have you.

If I may, Mr. Metzenbaum, respond to your previous question as well, first, I have no idea what my future holds for me. I can do a lot of things. I was in the military in the submarine service and I was in various aspects doing various jobs over the course of my career.

I suggest to you that I take my job very seriously, as do the bulk of my colleagues, if not all of my colleagues. We have a primary purpose of protecting the insurance consumer in our individual jurisdictions, and these folks, Mr. Metzenbaum, are your constituents as well. And we do take that job very seriously and I think we have done a rather decent job.

With reference to my predecessor, he did ultimately wind up involved in a process with this company that went defunct. I also have sued him, Mr. Metzenbaum, to the extent that we are trying to recover certain monies for his involvement in that particular process.

So, again, I suggest to you we do take our jobs very seriously. It is not where we are just coming in and going out like a revolving door. It is one that we are concerned and we care about what we do for the folks that we do that job for.

Senator **METZENBAUM**. Mr. Muhl, would you be good enough to furnish us with figures for the last 3 years as to the source of funding for meetings of the NAIC, as well as any other industry subvention of the NAIC?

Mr. **MUHL**. The bulk of those funds, Mr. Metzenbaum, come from either fees collected through a data base or those meeting fees that we charge for those who attend.

Senator **METZENBAUM**. Well, I am asking you whether you will give us the detailed financial figures with respect to the amount of industry subvention for the meetings, as well as any other industry subvention of the NAIC.

Mr. **MUHL**. I have no problem turning that information over to you, Mr. Metzenbaum. I do not have possession of it, but I will talk with the NAIC staff in Kansas City to see if we cannot get that information together and forward it to you.

Senator **METZENBAUM**. Do you have possession of it, Mr. Washburn?

Mr. **WASHBURN**. No, I do not. I am sorry, sir.

Senator **METZENBAUM**. All right. If you would, let us hear from you.

Mr. **LEVINSON**. Senator, if I may, the reason I suggested this minuscule premium tax to be collected by the NAIC is precisely because it would replace all current sources of funding. There would be no necessity to collect voluntary contributions of any monies from the insurance industry at all under that system.

Senator **METZENBAUM**. Well, my concern is that he who pays the bill oftentimes has influence and impact. The GAO, for example, found that the NAIC advisory committees were dominated by members of the industry. In fact, of approximately eleven advisory committees, seven were composed entirely by representatives of the industry. The total membership of all the committees was 114 from the industry; four, as compared to 114, consumer representatives; and two government agency employees and two academics.

How many advisory committees do you have now and would you guess that their composition is pretty much along the same line?

Mr. **WASHBURN**. Senator, if I could answer, some of the industry are agents or brokers who do not have——

Senator **Metzenbaum**. Are what?

Mr. **Washburn**. Are agents and brokers who not have interests the same as the companies. They are on a different spectrum of what the companies want. As a matter of fact, they usually represent their policyholders, and in that sense there is a balance.

There is not necessarily uniformity of industry interest out there. So I guess one of my problems is trying to define exactly what are consumer representatives as opposed to industry representatives. Usually, the agents or brokers are looking out for the policyholders and how they can market their product better.

Senator **Metzenbaum**. Well, would you be good enough to give us the data as to composition of the advisory committees at the present time?

Mr. **Washburn**. Sure.

Senator **Metzenbaum**. Mr. Muhl, is it your position that the State insurance commissions have protected the public from excessive and unjustified rate increases over the past two or three years?

Mr. **Muhl**. In my opinion, the State insurance departments have done just that. The rates that you see and that you have alluded to earlier where they have gone up 200, 300 percent—I think personally, particularly in my State, the rates that are being charged today fairly represent the risk exposure that is involved.

Sure, rates did go up, but you also had rates that were severely inadequate for a long period of time.

Senator **Metzenbaum**. How do you explain the situation with respect to the day care centers? According to a January 1986 report by the National Association for the Education of Young People, almost two-thirds of family day care homes and over one-third of child care centers had their liability insurance canceled or not renewed in 1985.

About 60 percent of the child care programs experienced a rate increase in 1985, and half of these reported increases of over 100 percent. Yet, despite these huge increases, nine out of ten child care programs have never had a claim.

The programs report very few claims and the vast majority are under $500.

Now, how do you explain that? Is it because the American people do not understand it? They read these facts, they read these figures, and they do not understand it and they do not feel that their insurance commissioners are giving them adequate protection.

Mr. **Muhl**. Well, first, let me suggest to you that the whole concept of insurance is spreading that risk over as large a number of exposures as possible in order to lessen the impact of any given loss.

There are going to be folks who have had no claims whatsoever that are going to wind up paying for those who did. That is the concept and the idea of insurance.

With reference to the day care folks, that was mainly a speciality market. The bulk of the day care centers had their insurance through a speciality company, and I think it was Mission, if I am not mistaken.

At any rate, that particular insurance company is now in receivorship; it went belly-up, insolvent.

Senator METZENBAUM. Why did they do that? I did not hear that.

Mr. MUHL. The one particular company that was a speciality market for all intents and purposes that insured the bulk of the day care centers throughout the United States experienced severe financial problems and ultimately went insolvent.

Senator METZENBAUM. Was that on the basis of their loss ratios or was it because they just did not run their business well?

Mr. MUHL. It was based on loss ratios.

Senator METZENBAUM. Can you present us with those facts and figures?

Mr. MUHL. I would be more than pleased to.

Senator METZENBAUM. Can you tell us the name of the company?

Mr. MUHL. I think it was Mission, if I am not mistaken.

Senator METZENBAUM. Where was it licensed?

Mr. WASHBURN. It was licensed in nearly all the States. Mission was licensed in just about every State, but it was a California-domiciled company.

Senator METZENBAUM. It seems to run contradictory to the information we have about there being very few claims and most of them being under $500. So if your evidence is to the contrary, I would just like to know the facts.

Mr. WASHBURN. We in Illinois have been trying to find out about day care centers ever since that happened, too, because we have been trying to, A, get people to write day care centers, and, B, find out what the proper rate ought to be for day care centers.

One of the problems we face is the increasing number of complaints of sexual abuse for children. I mean, it has become a national consciousness and I think, to be quite frank, that that scared the insurance industry a great deal. For that reason, many of them did pull out of the business.

I mean, we are still trying to find out what the loss ratios on the rates were that increased in 1985, and to be quite frank, I think you will not know for several years—that is one of the problems of the business—as to whether the rate was too high or too low.

Senator METZENBAUM. Senator Biden, did I understand you had some questions?

The CHAIRMAN. Yes. I apologize for coming back.

Senator METZENBAUM. No, do not apologize for coming back. We are glad to have you.

The CHAIRMAN. We hear a great deal these days, gentlemen, about the crisis in the reinsurance industry. Many companies have been charged with fraud and others are going bankrupt.

What impact does this have on the insurance crisis? Is the unavailability of some kinds of property and casualty insurance directly related to this problem in any way? Mr. Levinson?

Mr. LEVINSON. The problem of reinsurance, Senator, is the critical problem in our industry. You know, I hate to even use the word "reinsurance." From my view, there are only two things. There is "marketing" and there is "risk-taking."

We tend to call "marketing" insurance, and "risk-taking" reinsurance, although that is an oversimplification. The fact of the matter is that capacity has dried up as a result of losses, and ratios that are required. Reinsurance companies began to withdraw from the market.

Moreover, the problem of getting reinsurers, particularly alien reinsurers, to pay claims to insolvent companies that are legitimate claims also has become increasingly problematic over the last couple of years.

As I said earlier in my prepared remarks, no State regulator, no matter how conscientious, can know for certain the solvency of everyone who insures in his State and reinsures, and reinsures the reinsurers and soon. It goes on indefinitely.

The system is dependent upon each regulator doing his job perfectly. It seems to me that most regulators do, and my suggestion earlier was that the NAIC be empowered to make certain that those few and occasional States that fail to meet their responsibilities in this area, in fact, change their ways and do their duty.

The CHAIRMAN. Mr. Washburn?

Mr. WASHBURN. Reinsurance, of course, is just providing capital for the primary company to write the business and they indeed count on the primary company to underwrite the business and to pay the claims and to do everything.

It was a very easy way for companies who wanted to get into financial services to get into the business. As a matter of fact, they call it the innocent marketplace, and this was when the interest rates were high.

This was one of the things that helped drive the competitive machine of insurance in those days. What we are finding out is that, indeed, reinsurers are going insolvent, and reinsurers who were affiliated with major companies.

I took over an insurance company, Pine Top, that was affiliated with Greyhound and it had a great deal of reinsurance business. We are now trying to find out what happens when Greyhound is insolvent to the primary companies it reinsured.

There were a couple of items that we have done to try and look at reinsurance.

The CHAIRMAN. I am led to believe that most, or at least many, of these reinsurance companies are foreign-based.

Mr. WASHBURN. Many are based out in—it is very easy to start up a company in the islands, the Grand Cayman Islands, the Turks and Caicos, Bermuda, and so forth. And so a company, if it wanted to get into financial services, a Greyhound or some other company could go out to Bermuda or the Bahamas, and so forth, start up a company for very little capital out there and reinsure business onshore.

The CHAIRMAN. Right. Now, at this point, does anybody have any jurisdiction over that? Can anybody go to Bermuda and look and see?

Mr. WASHBURN. Basically, what we did was before we would allow the primary company to take that reinsurance and to write it off their books, which is what they wanted for capacity, if they were not licensed in any of the States, then they had to come up with a letter of credit.

As a matter of fact, that rule just got passed 2 years ago and there is still a great deal of——

The CHAIRMAN. When you say "we," do you mean your State?

Mr. WASHBURN. I am saying the NAIC came up with a letter of credit, and basically that has passed in many of the large States and is being passed in most of the States throughout the U.S.

The CHAIRMAN. Do you know how many States it has passed in?

Mr. WASHBURN. I do not have the count today, I really do not.

That is one way we are trying to get a handle on reinsurance, but you are very correct. The reinsurance marketplace pulled back, and they pulled back in a lot of cases because of losses.

In some cases, there are solvent companies that are unable to pay the reinsurance claims because of balance of payment problems, because of money problems. That is turning out to be another problem that we have got.

The CHAIRMAN. It is a big problem, though, is it not? I mean, what are the proportions of the problem?

Mr. WASHBURN. We are not quite sure yet. It is the problem that we are seeing more and more in terms of insolvencies in the fact that the primary company counted on reinsurance that is no longer there.

We may or may not know soon how big a problem it is, but it is a problem that is gradually snowballing on us, that is correct.

The CHAIRMAN. How about in Maryland, Mr. Commissioner?

Mr. MUHL. There is, I guess in answer to the first part of your question, a lot of foreign reinsurance, but we also have a domestic reinsurance market located here in the States. That has been one of our problems.

One of the solutions to that problem in Maryland has been presently our legislature is now meeting to create a Maryland insurance exchange similar to that which they have in the States of Illinois, Florida, and in New York. We are looking at that as a possibility to aid and assist in keeping some of the capacity to our primary carriers in the State of Maryland, but it has been a problem in the past.

The National Association of Insurance Commissioners has been concerned with it. That is one of the reasons that most recently at our meeting in Boston in the summer we had invited insurance regulators from around the world to attend our meeting to create, as a first step, a dialogue with these folks trying to get a handle on this reinsurance business and the seeding of reinsurance business, and ultimately the reinsurance collectibles.

We made a very good first step and we intend to continue that dialogue with those folks trying to get a better handle on it.

The CHAIRMAN. My time is up. In my written questions, with your permission, Mr. Chairman, I would like to pursue this issue with you about what the impact of the repeal of McCarran-Ferguson would be, if any, on the whole reinsurance area and what, if anything, Congress should or should not be doing beyond repeal, or even if we do not repeal the McCarran-Ferguson Act. I have to be educated more on the problem, but it seems to be an awfully big potential problem.

Senator METZENBAUM. Senator Thurmond.

Senator THURMOND. Thank you very much, Mr. Chairman.

I would like to get a capsule answer very briefly on two questions from each one of you, and we will start here with Mr. Halperin.

First, how would the repeal of the entire McCarran-Ferguson Act affect the authority and role of the State insurance regulations?

Mr. HALPERIN. Well, the provisions that relate directly to leaving to the States the authority to regulate insurance—if they are repealed, I think that would cast into doubt the role and I think open the door to greater Federal regulation over a period of time and eventually push the States out. So I think while it might not be immediate that that would be the long-term effect.

Senator THURMOND. Mr. Levinson?

Mr. LEVINSON. Sir, I do not know the answer to that question.

Senator THURMOND. Now, if a predecessor answers it, there is no use going into detail; just say you agree with him. But if you have something different——

Mr. LEVINSON. I do not know the answer and my suggestion is no one knows the answer, and that is precisely the problem with repeal.

Senator THURMOND. Mr. Washburn?

Mr. WASHBURN. The thing I think that strikes me when I look at the repeal of McCarran-Ferguson is as we get——

Senator THURMOND. Speak up so we can hear you; speak into your microphone.

Mr. WASHBURN. As we get closer and closer to having the Federal Government involved, you create gray areas as to whose responsibility the regulation really is, and the regulated are always very quick to use that gray area to their own advantage. That, I think, is what causes me the concern.

Senator THURMOND. Mr. Muhl?

Mr. MUHL. Basically, I agree, Mr. Thurmond.

Senator THURMOND. As I understand it, all four of you are opposed to repeal of the McCarran-Ferguson Act.

Mr. MUHL. That is correct.

Mr. WASHBURN. Correct.

Senator THURMOND. Do you feel that it would ultimately bring Federal control of the insurance business if we do that?

Mr. HALPERIN. Yes.

Mr. MUHL. Yes.

Mr. LEVINSON. I do not know, and I think, Senator, it is not the question I ask myself. The question that I ask myself is "what are the problems and what is the best way to solve them," and I do not think repeal of McCarran-Ferguson is the best way to solve the problems, as I identify them.

Senator THURMOND. Would you answer?

Mr. HALPERIN. Well, I do believe that is where it would lead and I do not believe it is the best way to solve the problems, and I would state that if we can identify certain limited problems, perhaps strengthening these boycott or coercion provisions, particularly as they relate to the smaller States, then that might be a need. But I think we should first identify the need and then provide the Federal jurisdiction in those limited areas if it is necessary.

Senator THURMOND. Now, the second question very briefly. How would the repeal of only the antitrust immunity provision of the Act affect the States' authority?

Mr. HALPERIN. Well, there I would have to answer more in the way Mr. Levinson did. I think that is a lot less predictable. I think, though, that given the long history, over 40 years, of the present system and then simply relying upon the State action doctrine might, in fact, prove to be inadequate.

We would find that questions would be raised over a period of time that could go beyond what we might anticipate so far as undermining the States' authority.

Senator **Thurmond**. Mr. Levinson?

Mr. **Levinson**. I do not know what the effect would be, but once again, sir, I think there is an alternative and it is the alternative that I suggested.

Senator **Thurmond**. And what was the alternative? I had to step out.

Mr. **Levinson**. The alternative is to give the authority and resources to the NAIC and give them an opportunity to solve the problem.

Senator **Thurmond**. Mr. Washburn?

Mr. **Washburn**. I do not know, Senator; I really do not have an idea.

Mr. **Muhl**. I think, Mr. Thurmond, by repealing at least the antitrust provisions and the exemption on that, there are all kinds of things that have the potential of happening, which we outlined in our printed testimony.

But I think by elimination, if you will, of that exemption, you are really and ultimately expanding as a result of the State action doctrine certain immunities that the insurance industry would have that they do not now have presently, and I think there are certain dangers involved in that.

If you decide to go in that direction, I would urge you to make sure that it does not ultimately have that adverse effect.

Senator **Thurmond**. Thank you, gentlemen, very much. Thank you, Mr. Chairman.

Senator **Metzenbaum**. Thank you.

Let me put to rest once and for all the question of repeal of the antitrust portion, I think it is Section 2(a), that provides that the business of insurance and those engaged therein shall be subject to State laws relating to regulation and taxation of insurance.

We have no intention of repealing that. I think that the way the bill is originally drafted, it would lead to that understanding so I think the comments are fair and appropriate. But we will see to it that that particular provision will not be repealed because the intent is only to repeal the antitrust exemption and not to deny the right to the States to provide the regulation and the taxation that they presently are engaged in.

Senator Heflin, did you have any further questions?

Senator **Heflin**. Well, following the line of questioning that Senator Thurmond raised in his last question and your comments, I would assume that you have had experience with courts. It would probably be 30 or 40 years after extended litigation before we would really know the effect of the repeal of the antitrust provision on such things as whether you could jointly meet and jointly oppose taxation, or whether you would jointly meet and oppose regulations.

I would assume that nearly every aspect of joint efforts on the part of people in an industry, agents, reinsurers, insurers, etc.

would be subject to litigation pertaining to the matters in regard to certain fields.

I think it would be like the general aspect of antitrust laws. There is already a body of law there, but it has some unusual aspects. I think that the repeal would show a positive preemption doctrine.

You have all sorts of aspects that will work, and I would certainly think that many matters would be litigated before we would know the end result, even with the body of antitrust law that we have today.

Senator **Metzenbaum**. Thank you.

Thank you very much, gentlemen. We appreciate your cooperation.

Our next panel consists of John Motley, Director of Federal legislation for the National Federation of Independent Businesses; J. Robert Hunter, President of the National Insurance Consumer Organization; Dr. Leslie W. Seldin of the American Dental Association; John Satagaj, President of the Small Business Legislative Council; and Dr. Mark Cooper, Director of the Consumer Federation of America.

If you are leaving, be good enough to leave promptly and quietly. If you are remaining, please be good enough to take your seats. If you are socializing, please do it in the hall.

Mr. Motley, you are Director of Federal legislation for the National Federation of Independent Businesses. We are happy to hear from you, sir.

STATEMENT OF A PANEL CONSISTING OF JOHN MOTLEY, DIRECTOR OF FEDERAL LEGISLATION, NATIONAL FEDERATION OF INDEPENDENT BUSINESS; J. ROBERT HUNTER, PRESIDENT, NATIONAL INSURANCE CONSUMER ORGANIZATION; JOHN S. SATAGAJ, PRESIDENT, SMALL BUSINESS LEGISLATIVE COUNCIL; MARK N. COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA; AND LESLIE W. SELDIN, VICE CHAIRMAN, COUNCIL ON INSURANCE, AMERICAN DENTAL ASSOCIATION

Mr. **Motley**. Thank you very much, Mr. Chairman. On behalf of NFIB and its more than 500,000 members coast to coast, I want to thank you for the opportunity to testify today on S. 80, and also on the repeal of the antitrust exemption contained in the McCarran-Ferguson Act.

Before I testify, I would like to submit my full testimony for the record, and include three documents which are mentioned in that testimony; they are an NFIB survey called "Small Business Problems and Priorities," a demographic break-out of NFIB's membership, and the number one recommendation of the recently concluded White House Conference on Small Business.

[The following were received for the record:]

Profile of NFIB Members

Document #1

A. By Business Form:

Corporations	275,458	(53%)
Unincorporated	244,274	(47%)
Total Membership (Nov. 1986)	519,732	

B.	NFIB Membership By SIC Code	General Small Business Population By SIC Code*
Retail	30%	31%
Service	26%	21%
Wholesale	8%	11%
Non-capital intensive	64%	63%
Manufacturing	13%	10%
Construction	13%	12%
Agriculture	5%	2%
Transportation	3%	4%

C. Percent of NFIB Members by Gross Sales

Not Determined	2%
Less than $50,000	8%
$50,000 - 99,999	12%
$100,000- 199,999	15%
$200,000-349,999	14%
$350,000-799,999	18%
$800,000-1,499,999	13%
$1,500,000-2,999,999	8%
$3,000,000- or more	9%

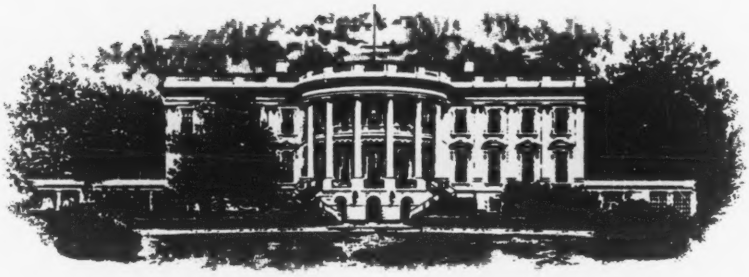
D. Percent of NFIB Members by Number of Employees

1	7%
2	11%
3-5	27%
6-9	20%
10-14	12%
15-19	5%
20-39	9%
40 or More	8%
Not Responding	1%

*Source: The State of Small Business, A Report of the President, May, 1985

Document #3

The White House
Conference on Small Business



A Report
to
The President of the United States

November 1986

FINAL RECOMMENDATIONS

WHITE HOUSE CONFERENCE ON SMALL BUSINESS

1 Because the liability insurance crisis in the United States has not only become a life and death sentence to many small businesses, but also is changing adversely our way of life, we must pursue a four-pronged effort at reform: civil justice reform; uniform standards for product, professional, and commercial liability; regulation of the insurance and reinsurance industries; and viable affordable alternatives to liability coverage.

We, therefore, strongly urge the President, the Congress, and the state legislatures to implement the following action as a vitally important step in alleviating the problems of availability and affordability of liability insurance to small business in America:

a. Civil Justice Reform:

1. Return to a fault-based standard of liability.

2. Base causation findings on credible scientific and medical evidence and opinions.

3. Eliminate joint and several liability in cases where defendants have not acted in concert.

4. Limit non-economic damages (such as pain and suffering, mental anguish, or punitive damages) to a fair and reasonable maximum dollar amount, not to exceed $250,000 in any case.

5. Restrict punitive damage awards to cases of willful and malicious conduct. The amount awarded shall go to a governmental trust fund, not the plaintiff.

6. Limit attorney contingency fees to reasonable amounts, on a sliding scale.

7. Reduce awards in cases where a plaintiff can be compensated by certain collateral sources, to prevent windfall double recovery.

8. The prevailing party in a legal action should have a statutory right to recover costs and attorney fees from the non-prevailing party.

9. Impose a uniform, reasonable statute of limitations and repose in all tort actions, and hold defendants to the state-of-the-art in existence at the time a product was manufactured or a service was performed.

10. Provide for periodic instead of lump-sum payments for future medical care or lost income.

11. Encourage use of alternative dispute resolution mechanisms to resolve cases out of court.

b. Federal Standards for Product, Professional, and Commercial Liability: Establish a uniform standard of fault-based product, commercial, and professional liability which incorporates provisions cited in "Civil Justice Reform," above.

c. Availability and Affordability of Liability Insurance and Reinsurance:

1. Review McCarran-Ferguson Act of 1945 as it applies to state regulation of insurance and the industry's limited exemption from antitrust laws.

2. Promote the establishment of joint underwriting associations and assigned risk pools.

3. A minimum of 60 days notice should be required if an insurer decides not to renew a policy or to increase its unit premium by more than 25 percent. Mid-term cancellations should be prohibited and premiums should be based on experience ratings.

4. Promote tax-deductible self-insurance through risk pooling and other group arrangements, including the expansion of the Risk Retention Act of 1981.

5. Legislate a self-insurance system that would allow small businesses to pay premiums into a fund with pre-tax dollars. The fund could be used for no other purpose than the payment of claims, with the fund being regulated in the same manner as any other insurance company.

6. Require the insurance industry to make complete financial disclosures by lines of insurance, so that Congress, state legislatures, and state insurance commissioners may call on this information at any time.

d. Education: Realizing that the most effective long-term solution to the liability insurance problem is a knowledgeable citizenry, we urge an ongoing education program to develop an awareness that:

1. The litigious nature of the American public will profoundly affect our way of life as the cost of public and private facilities becomes unaffordable.

2. There is no such thing as a riskless society, so each of us must assume some responsibility for his/her own safety and the normal hazards of everyday living.

[*1,419 votes of 1,715 ballots cast*]

2 There should be no government mandated employee benefits, such as employer-paid health benefits, parental leave, disability leave, etc. Specific actions should include, but not be limited to, the following:

a. Congress should prohibit the states from mandating employee benefits.

b. Congress should reject parental and disability leave legislation, such as H.R. 4300 and S. 2278.

c. Congress should reject proposals to mandate medical coverage. Business supports creative efforts in the private sector to identify new and voluntary approaches to enable working parents to fulfill their job and family responsibilities.

[*1,360 votes*]

3 Government at all levels has failed to protect small businesses from damaging levels of unfair competition. At the federal, state, and local levels, therefore, laws, regulations, and policies should:

a. Prohibit unfair competition in which non-profit tax-exempt organizations use their tax-exempt status and other advantages in selling products and services also offered by small businesses.

b. Prohibit direct, government-created competition in which government organizations perform commercial services.

These goals should be achieved by, but not limited to, the following ways:

Non-profits: Tax-exempt entities should not be permitted to use their tax status or postal rates to compete with commercial providers of products and services. Non-profit organizations receiving government grants and contracts, including federally funded research-and-development centers, should be prohibited from using federal dollars to compete with products and services provided by the private sector. Non-profits engaging in commercial activities should be prohibited from doing so while enjoying exemption from government regulations such as antitrust laws, worker's compensation, and health and safety rules.

Mr. **Motley**. Mr. Chairman, the main reason that I am here today is because of the liability insurance crisis which many of the other witnesses have mentioned and discussed.

In addition to the tens of thousands of telephone calls and letters that NFIB received over the last 2 years on this crisis, some of the other things that we have done, I think, also point out the seriousness of it.

The survey that I mentioned before, the 1986 problems and priorities survey, listed the cost and availability of liability insurance as the number two problem facing the small business community last year; that is number 2 out of 75 possibilities. In addition, 38 percent of the respondents listed it as the most critical problem being faced by their business.

The seriousness of the problem was verified by the White House Conference on Small Business because the recommendation dealing with liability insurance became the number one recommendation of that conference, with 83 percent of the delegates attending voting in favor of it, 1,419 out of 1,715 delegates attending.

As part of that recommendation, they urged that Congress review the McCarran-Ferguson Act and the antitrust exemption contained within it.

Senator **Metzenbaum**. Eighty-three percent of your——

Mr. **Motley**. Eighty-three percent of the delegates attending the White House Conference on Small Business voted for the number one recommendation, which is a recommendation dealing with the liability insurance crisis, which called for this committee or for Congress to review the antitrust exemption in the McCarran-Ferguson Act.

We have seen some stories recently that the liability insurance crisis is easing for small business owners across the country. NFIB runs a constant field survey as its representatives go back and visit members to renew their membership every year.

Two questions are being asked on the current field survey. Number one, what is the most important problem facing your business today, and they are given a series of six choices. Liability insurance is the number one problem faced by 44 percent of the respondents still today.

In addition, 42 percent of the respondents indicate that their liability insurance costs have gone up at least 50 percent in the last year.

NFIB believes that the causes of the liability insurance problem are very complex and varied. Primarily, though, we think that there are three causes: number one, a civil justice system that is in need of some reform; number two, a patchwork quilt of haphazard State regulation of the insurance industry; and number three, the business practices of the insurance industry.

The solutions that we propose for taking a look at these problems are really based upon the majority positions of NFIB members as we poll them throughout the year. During 1986, we polled our membership on a whole spectrum of different solutions to the problem. Let me just give you some of these figures to show you where they are coming from.

Eighty-one percent of those members responding to our poll favored comprehensive tort reform; 65 percent favored a national product liability tort reform bill; 60 percent favored repeal of the antitrust exemption within McCarran-Ferguson.

I would also mention here, Mr. Chairman, that 67 percent of the members in that same poll opposed replacing the current system of State regulation of the insurance industry with minimum Federal standards.

That really brings me to the point of why we are here today, and that is to discuss your bill, S. 80, and also the repeal of the antitrust exemption for McCarran-Ferguson. NFIB strongly supports the repeal of that antitrust exemption which is contained in the McCarran-Ferguson Act. Why?

Well, NFIB members over the years have opposed all exemptions to the antitrust act, and specifically, as I cited before, they have voted in favor of repeal of the one in McCarran-Ferguson.

Number two, our review of the situation in the insurance industry shows no continuing market justification for that exemption. Number three, the exemption, to us, no longer makes any judicial sense.

In short, Mr. Chairman, the burden of proof of keeping the current exemption for the insurance industry, NFIB believes rests with the insurance industry itself.

Let me just say a word about State regulation and the strong vote of NFIB members——

Senator METZENBAUM. I am trying to hold this panel and the next one to the 5-minute rule. I have tried to be lenient, but it is past 1 o'clock.

Mr. MOTLEY. Certainly, Mr. Chairman. Let me just conclude, then, by saying that we believe, like some of the other witnesses who have testified here earlier, that as presently drafted S. 80 would be too broad and would be a threat to the regulation of the insurance industry by States.

We would suggest a more narrowly drawn statute, one which deals with the antitrust exemption itself. While we favor repeal, though, let me reemphasize that we think that the problem is a complex one and we would urge this committee not to ignore either the need for a national product liability tort reform bill or for a review of the tort reform system or civil justice system of the country.

Thank you very much, Mr. Chairman.

[Prepared statement follows:]

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National Federation of Independent Business

NFIB

STATEMENT OF

JOHN MOTLEY
DIRECTOR OF FEDERAL LEGISLATION

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Senate Committee on the Judiciary
Subject: Modification of the McCarran-Ferguson Act of 1945
Date: February 18, 1987

Introduction

On behalf of the over 500,000 members of the National Federation of Independent Business, I would like to thank you, Senator Metzenbaum, for holding these hearings on the McCarran-Ferguson Act and to the rest of the Judiciary Committee members for participating in them. We at NFIB are particularly grateful that the hearings are at the full committee level. To us, elevation of these hearings to the full committee represents both the commitment Judiciary Committee members have toward understanding this issue and their desire to take the appropriate action once the hearings are concluded.

As you may know, the National Federation of Independent Business has been concerned over the years about the general issue of insurance. We primarily represent main street and rural small businesses -- our average members employs less than ten individuals. Our members could be considered a leading indicator of the economy. When the general economy prospers, our members generally prosper. When the economy does not do so well, our members generally feel immediate economic pain through lower sales of goods and services. With the Chairman's permission, I would like to have included in this testimony a demographic view of NFIB (Document #1).

Because we represent such a cross section of small business, we believe we can say with certainty that NFIB speaks for America's entrepreneurs. And the concern dominating entrepreneurs' thoughts is insurance.

NFIB members were among the first to feel the so-called "liability insurance crisis" experienced in our country over the past several years. I use the phrase "liability insurance crisis" because many saw no logical or market-based justification for small business liability insurance premiums dramatically increasing in price regardless of their risk rating, and for the significant cut many faced in insurance coverage. NFIB has received many calls and letters from small business owners who were good risks for liability insurance policies but who cannot even get insurance, no matter the price, because policies were no longer offered.

We are here before this committee because the liability insurance issue is probably the most critical and serious issue confronting small business today. NFIB's Institute for Enterprise Advancement issued its Small Business Problems and Priorities in June of last year, ranking the top 75 problems small businesses face. In that survey, small business ranked the cost of health insurance as its number one problem area, with 33% of those sampled noting it was a critical problem. They ranked the cost and availability of liability insurance as the number two problem. However, 38% of small business viewed this as a critical problem, the highest percentage describing a problem as "critical" in the survey. With the Chairman's permission, I would like Small Business Problems and Priorities to become part of the hearing record (Document #2).

Furthermore, NFIB's field force of over 700 individuals regularly conducts a field survey with small businesses across the nation to get a sample of their views and concerns. Our last two field surveys provided us with the following data:

- Asked the question of which issue is the most important affecting business, 44% chose liability insurance;

- Asked if liability insurance premiums had increased by 50% or more, 41.5% said yes.

These field surveys reveal to us, Mr. Chairman, that the liability issue has not gone away.

Furthermore, the number one priority at the White House National Conference on Small Business, made up of 1,813 delegates and held in Washington last August, was the liability insurance issue. With the permission of the committee, I would like that recommendation to be part of the record (Document #3). I might point out that specific reference in the recommendation is made to McCarran-Ferguson, asking for review of the act itself.

All of this data tell us that the insurance issue is on the minds of small business owners everywhere and that action must be taken to resolve the problem.

While you may have heard examples of small business difficulties with liability insurance, I would like to give the committee some examples of problems generally being faced by NFIB members. They include:

--A laundromat owner in Corpus Christi was sued because a lady was mugged in one of his laundromats. He refused to pay, but his insurance company settled with the lady out of court. In 1985 he paid $900 for $2 million in coverage. In 1986 he is paying $3,625 for $1 million in coverage.

--A small chemical company (14 employees) in Gulfport, Mississippi paid $4500 for $300,000 coverage. In 1986 they have been quoted a premium of $38,000 for $500,000 coverage.

--A campground in Hagerstown, Maryland in 1985 was charged less than $1000 for $1 million in coverage. In 1986 the same coverage costs $8000.

--A plumbing and heating contractor in Warren, New Jersey received notice that his policy had been cancelled without explanation.

--An aircraft corporation in Waco, Texas paid $25,000 in 1983, $50,000 in 1984, and $200,000 in 1985 for $2 million in coverage.

--A five-and-dime store in New Lexington, Ohio has seen premiums increase 20% between 1984-1985 and 50% between 1985-1986.

--A manufacturer of food processing machinery in Marblehead, Ohio paid $50,000 with a $2500 deductible in 1985. In 1986 the premium is $150,000 with a $50,000 deductible. The 1986 policy would also require the manufacturer to pay legal expenses for settling claims and to provide a letter of credit to the insurer in the amount of $300,000.

--An elevator repair and maintenance company on Staten Island paid $3500 for $5 million in coverage in 1984. In January 1985 the policy cost $17,500. In July 1985 the policy was cancelled. Another carrier has offered coverage for $72,000 in annual premiums.

--An auto parts and towing company in Walton, Ohio is being charged $20,000 this year for coverage which cost $11,000 last year.

--An insurance agent in Boundbrook, New Jersey received notice from two companies that they were no longer accepting any applications for commercial liability insurance. Also, these companies were reviewing all renewals for possible termination.

NFIB believes there must be a comprehensive solution to the insurance liability crisis. We believe that there are three causes which have contributed to the problems we face today:

(1) An out-of-control tort system;
(2) Poor insurance industry business practices;
(3) A patchwork quilt of haphazard state regulations.

Recognizing multiple causes of the problem requires us to look at multiple solutions. It would be irresponsible to attack one problem area, resolve it, and then walk away from this issue thinking it is solved. There must be a comprehensive approach and solution.

Furthermore, our members do not want to single out one individual, group, or institution to blame for the crisis. They only want it resolved so they may go about their business -- the business of small business, generating new wealth and creating virtually all the new jobs in this nation.

NFIB members believe an appropriate approach should include a national uniform product liability law, comprehensive tort reform, and pro-competitive changes made in the current structure of the insurance industry. To this end, we hope that those in the industry who believe market forces should predominate, not regulation either by the public or private sector, will come forward to join us in our attempt to make insurance fairer for the small businessman to buy and to rely upon. It is not our intention to "bash" insurance companies, lawyers, or state regulators in attempting to jawbone the price of insurance down and to expand its coverage. It _is_ and will be our aim to work for those fundamental changes which will bring about better coverage at a lower price.

NFIB Mandates

As you probably know, The National Federation of Independent Business is a lobbying group which bases its policy on the views of its membership. Issue positions percolate up from grassroots, rather than being imposed on the more than 500,000 members from our President or the Board of Directors. We are very proud of our decision-making process, most especially because it keeps us in touch with the issues important to the membership.

We hear from the membership by a combination of surveys, meetings, daily contact by our field force, and through the use of the Mandate. The Mandate, in particular, is a bi-monthly poll we send to all members to solicit their views on issues. We ask them to take a position on an issue based upon their own beliefs and experiences. We provide them with an objective background summary on the issue. They complete the Mandate and send it back to us. We tally the results and use these results for our work on Capitol Hill. All of you receive a summary of the Mandates from us so you, too, know what your small business constituents are thinking. Using the Mandate is how NFIB has developed its position on insurance. Basically, our members want the following positions included in any liability package:

	Membership Mandate Vote
*Comprehensive tort reform (return to a fault-based standard, elimination of joint and several liability;	81% Favor 10% Oppose 9% Undecided
*Uniform national product liability law;	65% Favor 27% Oppose 8% Undecided
*An expedited claims process;	65% Favor 23% Oppose 14% Undecided
*No federal minimum standards for insurance companies to follow; and	26% Favor 67% Oppose 7% Undecided

*Elimination of the antitrust exemption provided in the McCarran-Ferguson Act.	60% Favor 26% Oppose 14% Undecided

While NFIB understands that the focus of this hearing is on the McCarran-Ferguson Act, we cannot overestimate the need for Senate Judiciary Committee members to view the liability crisis as a complex issue. Its solution will rest on the success of making a number of changes in public policy, not just eliminating the antitrust exemption within the McCarran-Ferguson Act.

The Cause of the Crisis

I touched on the causes of the crisis earlier in the testimony. There is, as you know, wide disagreement on the cirumstances which led to the current crisis. The main dispute is between the insurance industry and the trial lawyers. The insurance industry lays most of the blame for the situation on the attorneys and the civil justice system. They claim that excessive litigation, overly generous court awards, and greedy attorneys have strained insurance reserves and thus raised the costs of underwriting. While admitting that they underpriced insurance to gain investment capital when interest rates were high, they maintain that tort reform is the answer to the problem.

The attorneys accuse the insurance companies, disclaiming the notion that Americans have become more litigious and that attorneys do little to discourage frivolous lawsuits. They contend that most of the problems are due to poor management of investments made by the insurance companies, and they point to the companies' strong performance in the stock market as evidence of the healthy financial status of the industry as a whole.

Still one other group must be mentioned. State regulators -- the insurance commissioners -- have done little fingerpointing except at erroneous predictions regarding interest rates, upon which they made many decisions. Although they must operate within statutory limits, they all have authority to review rates either before or after implementation. However, like state tort law, the theory and practice of insurance regulation varies widely from state to state.

We see some truth to all sides' arguments. Since today's hearing is focused on McCarran-Ferguson, that will be the focus of the rest of the testimony.

Insurance Industry Reform

Has the market failed? That is the fundamental question many are asking today about the insurance market because its answer has profound public policy implications. The industry itself has blamed the soaring premiums and reductions in coverage on previous cut-throat competition, i.e. too much competition among those in the industry. Other experts have argued that there exists a business cycle for insurance; we are currently experiencing the "bust" of the cycle, with better times to follow. There are others who believe the market has failed and offer the solution of increased federal regulation. No consensus has emerged to answer this question.

NFIB believes the market process itself has not failed. We view the current, complex insurance environment as one in which competition within the market has been hindered.

Our membership is generally concerned about the exercise of discretion by insurance companies in cancelling or not renewing policies. Notification periods are often short, and little if any explanation is given to the policyholder. Claims history seems to have no bearing on an insurer's decision to cancel or not renew. Industrywide cancellations leave insurance agents hard pressed to obtain coverage for clients, and small business owners have neither the time nor the expertise to seek out coverage for themselves. These are problems which insurance companies must come to grips with and solve. Not resolving these problems will increase the demand for more federal regulation of the industry.

One particular example of current law which hinders effective competition is the antitrust exemption contained within the McCarran-Ferguson Act. NFIB believes that the exemption contained within the law distorts competition in the insurance industry by its very existence.

It is the distortion of the market which compels us to urge this committee to repeal the antitrust exemption contained with the 1945 law.

The repeal of the antitrust exemptions contained within the McCarran-Ferguson Act makes sense for two reasons in today's environment. First and foremost, there is no market-based reason why there should be an antitrust exemption. Because there is no market-based justification, continuing the exemption is unfair and represents intrusion in the free economy by the federal government. Our antitrust laws were instituted to set the parameters for competition. Exemption from these laws represents a special interest granted to a specific industry. Our members want to see a level playing field for all companies, including those in the business of insurance. We believe the antitrust exemption hinders competition.

Second, the reason for the continuation of the antitrust exemption, passed by Congress to ward off a court-inspired regulatory crisis, no longer makes judicial sense. We need to simply accept that the business of insurance is, in fact, interstate commerce and needs to be under the scope of antitrust laws.

Congress enacted the McCarran-Ferguson Act in 1945 in response to a Supreme Court ruling in 1944 (U.S. v. South-Eastern Underwriters Association [322 U.S. 533]). The Court had ruled that the business of insurance was interstate commerce and, therefore, subject to federal antitrust laws. The McCarran-Ferguson Act, P.L. 79-15, named after its sponsors, Senators Patrick Anthony McCarran of Nevada and Homer Ferguson of Michigan, was designed to ensure the preeminence of the state regulatory system already established and to prevent new federal regulation of the insurance industry. Antitrust law, specifically the Sherman Act, the Clayton Act, and the Federal Trade Commerce Act, would only apply "to the business of insurance to the extent that such business is not regulated by state law."

An earlier court ruling, Paul v. Virginia [15 U.S.C. 168], in 1869 had held that the business of insurance was not interstate commerce and therefore not subject to federal regulation. This decision was the basis for the state regulation system which was a unique American experience. Insurance companies used the immunity from federal regulation to share information on their business: risk and loss experience, actual data and predictions, and some would argue, to limit competition within their industry.

Clearly, in 1945, the Congress and President Roosevelt were in a dilemma. They apparently wanted state regulation to continue, while making it consistent with the 1944 court ruling. Roosevelt suggested to Congress that a moratorium be enacted on antitrust regulation so the insurance industry would have time to adjust. However, Congress responded with McCarran-Ferguson by simply exempting the industry from federal regulation so long as there was regulation by the states. The Act provided no standards for regulatory performance or for congressional oversight to see if the Act was accomplishing its purpose.

The three critical aspects of McCarran-Ferguson for the antitrust exemption to apply are the following:

(1) The activity must be the "business of insurance;"

(2) The activity must already be regulated by state law;

(3) The activity cannot be agreements to boycott, coerce, or intimidate (such activity would be subject to the Sherman Act, even if state regulation existed).

Competition Essential

Our first reason for opposing the antitrust exemption, as I previously mentioned, comes from a competitive standpoint. NFIB believes that the antitrust laws when properly enforced, protect the competitiveness of our free market economy. In fact, they are inextricable to our system. The Supreme Court has called our antitrust laws "the Magna Carta of free enterprise," noting in U.S. v. Topco Associates, Inc. [405 U.S. 596]:

> "They are as important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed every business, no matter how small, is the freedom to compete -- to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster."

Furthermore, the Supreme Court has recognized the wisdom and importance of a market economy which is based upon competition. The Supreme Court wrote in Northern Pacific Railway Co., U.S. [356 U.S. 1]:

> "Unrestained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions."

Simply put, Mr. Chairman, the burden of proof on why we should continue the antitrust exemption is on the insurance industry. The exemption is a clear deviation of the way we do business in this country. It obstructs the market economy by granting a special privilege to a particular group of individuals who perform a particular function within our economy. Antitrust prosecutions in related industries, particularly in the banking and securities fields, which one could argue are similar to the insurance industry, have not been incompatible with their regulatory schemes.

Some questionable practices within the insurance industry have come to us from the small business community. Both examples here suggest that there may be non-competitive events occurring:

- --A small businessman from California who shopped for liability insurance and found policy prices were generally the same. He concluded they may be some form of price-fixing taking place;
- --So-called "administered pricing" for workers' compensation insurance in at least forty states which do not have competitive rating laws.

The anti-competitive exemption within McCarran-Ferguson should not only apply to the industry, but also to the state regulatory bodies which make and enforce rules. Your opportunity here today is to end anti-competitive regulations and practices by bodies either in the private or public sector. The elimination of the antitrust exemption should achieve this important goal. The exemption has allowed insurance regulation to become politicized on the state level, promoting anti-competitiveness to some degree. Now, one would expect a variety of regulations and rules with 50 state insurance commissioners or commissions charged with the responsibility to see that rates are adequate but not excessive or unfairly discriminatory. But there may be some non-competitive elements to this structure. Some have suggested that state insurance departments lack the necessary data and expertise to address ratemaking. Others in the field argue the state commissioners or commissions find it difficult politically to push insurers to raise prices to ensure solvency and there is pressure from insurers who threaten to withdraw from a state if rates are tampered with. Surely the states must also keep the federal antitrust laws in mind when they go about their regulatory function.

Having a level playing field where the insurance sector lives under the same rules of the economic game as every other industry is essential to resolving the insurance crisis for the long term.

Given the Supreme Court's initial ruling in _Paul v. Virginia_, it is not surprising that many were taken by surprise when the court ruled in the SEUA case in 1944. But now everyone understands the ruling, and the threat of federal regulation based upon the case no longer exists. Eliminating the antitrust exemption in McCarran-Ferguson will not open the door to new federal regulations. It will only ensure that no antitrust laws relating to the business of insurance, i.e. commerce, are violated. The sole reason for the antitrust exemption was, in my opinion, the fear of excessive federal oversight and regulation. This need not be the case. Consequently, we are basing our law on the panic of the post-1944 decision, which no longer is relevant. NFIB believes unnecessary laws should be stricken from the books, particularly if, as pointed out earlier, they are counterproductive and anti-competitive.

One issue of caution which has been raised about the elimination of the McCarran-Ferguson antitrust exemption deals with the need for those within the insurance structure to exchange data. Should the exemption be repealed, there seems to be no market obstacle to having data collection and dissemination from becoming a business. A clearinghouse for data could emerge in the market, following the interests of those who would value the information. We may even see a number of small businesses established to meet this data need.

No to New Federal Agencies or Departments

I would like to point out, Mr. Chairman, that while we support the elimination of the antitrust exemption contained within the McCarran-Ferguson Act, our membership does not support the "federalization" of insurance regulation or the establishment of a new agency or department to oversee the insurance industry. Our members believe in the free market economy and would not want to switch state regulation for federal regulation. We have been encouraged by the recent statements of Federal Trade Commission Chairman Dan Oliver, who has said he would like to investigate the business of insurance. We believe Chairman Oliver would parallel many of our concerns, pursuing a policy to increase competition so insurance coverage will be more affordable and allow for greater coverage. Although the prohibition Congress placed on the FTC in 1980 is under the jurisdiction of the Senate Commerce, Science and Transportation Committee, we hope that you relay to your colleagues our interest in this issue.

S. 80 -- Legislation to Repeal McCarran-Ferguson

S. 80, the legislative vehicle currently before this committee, would essentially repeal the McCarran-Ferguson Act in its entirety, providing a transition period for the insurance industry to adjust to the new legal environment. We want to commend you, Mr. Chairman, for introducing this legislation which focuses this hearing and the Senate on the problems with McCarran-Ferguson. But we believe it may go further than just our mandate to work for the elimination of the antitrust exemption. We believe complete elimination of the McCarran-Ferguson Act begs the issue of federal regulation. The specific intent of Congress to have the business of insurance regulated by the states would also be struck. NFIB would prefer that a final bill come out of this committee which would only eliminate the antitrust exemption contained within McCarran-Ferguson. The intent of Congress should continue to be that the business of insurance should be regulated by the states. Congress should keep state regulation of insurance its clear intent and priority. However, we do want to commend for your efforts in focusing attention on this critical issue to small business. NFIB appreciates your interest in this issue.

Conclusion

The National Federation of Independent Business believes the antitrust exemption contained within the McCarran-Ferguson Act of 1945 is anti-competitive and unnecessary. We would like the Senate Judiciary Committee to move forward quickly on legislation to eliminate the exemption. NFIB hopes more narrowly written language will reach the full Senate to achieve this end and that the House will soon hold hearings and move through the legislative process in a parallel fashion. We would like to see more discussion on lifting the prohibition on the Federal Trade Commission from investigating the "business of insurance." Attempts to emphasize pro-competitive policies in FTC studies should benefit both those who offer insurance and those who purchase it. Furthermore, I cannot conclude my testimony on insurance without requesting that Senators look at the other areas of the comprehensive solution. Members of this committee should make tort reform, a uniform product liability bill, and the other needed policy changes contained within this testimony high priorities.

In the end, only through a comprehensive view of the insurance crisis will we see insurance costs become reasonable and necessary coverage become available. Thank you again Mr. Chairman, for allowing the views of NFIB to be expressed here today.

0265T

Senator **Metzenbaum**. Mr. Hunter, it is nice to have you with us from the National Insurance Consumer Organization.

Mr. **Hunter**. Thank you, sir. I am accompanied by Jay Angoff, our counsel, as well, who may help us with some of the questions. And I assume, also, that the testimony will be in the record.

Senator **Metzenbaum**. The testimony will be in the record.

Mr. **Hunter**. Let me quote something to you, members of the committee. "Each member shall adhere to all filings made by the National Council on its behalf with State supervisory authorities." That is not language from some ancient document that I dug up out of the library, but from the current constitution of the National Council on Compensation Insurance, the rate-setting organization for workers' compensation.

Senator **Metzenbaum**. Bring the mike a little closer.

Mr. **Hunter**. I am sorry.

Insurance is almost a $400 billion a year industry and accounts for 13 percent of disposable income in the United States. Americans spend more on insurance than anything but food and shelter, and today, February 18th, is ironically the day that the average American worker has earned enough to pay off his or her insurance bill, assuming that they worked all the way from January 1.

It is fitting if today will also mark, as I believe it will, the beginning of a successful congressional effort to finally subject the insurance industry, like other industries, to free market forces in this Nation.

Rates in the insurance industry are often promulgated by rate bureaus. While the National Council requires adherence, other bureaus such as the ISO issue so-called advisory rates, permitting its member companies to deviate. Nevertheless, the issuance of these advisory rates would be illegal absent McCarran immunity, since it amounts to tampering with prices.

ISO rates are based upon a series of judgments. ISO takes reported losses and multiplies that by the reserves and estimates of patterns, of pay-outs over time, called loss development; and finally multiplies that by trend to guess what the future inflation is going to be.

So it is a pattern of significant cooperative effort to determine what the future will hold. If the insurance companies' individual judgments replace that, then the essence of price competition would be returned to the insurance industry, but ISO and these other rating organizations doing this loss development and trending makes the current McCarran-protected rate-making regime totally anti-competitive.

Not only do they do that, but they add joint expenses based upon the least efficient insurers and profit factors, which, among other things, ignore investment income. Therefore, they establish rates that protect the least efficient carriers that are their members and enable the more efficient carriers to earn super profits.

Now, most insurers do not have enough experience upon which to totally base their own rates, so if we do repeal the antitrust exemption, we have to be careful to make sure that the insurers can have data.

The insurers claim that antitrust enforcement would stop joint data, but I believe that is a red herring. We would welcome a chance to work with the insurers and the committee to draft language making clear that the repeal of the antitrust exemption will not prohibit insurers or the public from having access to pooled past data.

Regarding State regulation, we join with the others who have testified here today. We do not intend to undermine State regulation. The insurers' claim that the States cannot regulate if antitrust laws apply is not realistic. We agree with the testimony that, in fact, repeal of the antitrust exemption would strengthen and not undermine State regulation.

Finally, on the periodic crises that we face in this Nation, the bureau rate sometimes is not utilized. The insurers compete in so-called cash flow underwriting, but they know that the bureau rate is there. It is sort of like a safe home base, sort of like what we had in the game of tag as children. Once you are there, you are safe.

The McCarran-protected rate bureau rate functions as that home base functions in tag. Insurers during the competitive phase of the cycle can ignore the bureau rate and seek market share by cutting price. The price cuts are deeper and the duration longer than they would be if a free market were in place because the price-cutters know that they have that safe home base to jointly return to when the going gets rough.

Because the bureau rate is set at a level at which the least efficient member is profitable, the bureau rate allows insurers to earn excess profits. These excess profits attract significant capital at the top of the cycle, which sets the stage for price-cutting to begin again.

If insurance companies competed in a free market subject to antitrust laws, they would not be able to suddenly call a halt to price-cutting and sharply raise prices in concert.

Moreover, the knowledge that they could not raise prices in concert after cash flow underwriting would prevent them from engaging in such underwriting to such an extent and force them to more carefully evaluate risk and engage in risk-based underwriting rather than cash flow underwriting at all points of the cycle.

Because interest rates will continue to fluctuate and demand for insurance is relatively inelastic, the insurance cycle will not disappear if the McCarran immunity is eliminated, but the immunity will smooth out the cycle greatly and be a great help to ease future insurance crises.

Mr. Chairman, I see my time is up. I would just close by saying that I would encourage you to go forward this year. 1987, I believe, can be the year where finally we bring this giant industry into the mainstream of economics in this Nation.

[Prepared statement follows:]

NATIONAL INSURANCE
CONSUMER ORGANIZATION

STATEMENT
OF THE
NATIONAL INSURANCE CONSUMER ORGANIZATION

ON
REPEAL OF MCCARRAN-FERGUSON ANTITRUST IMMUNITY

BEFORE THE
SENATE JUDICIARY COMMITTEE

FEBRUARY 18, 1987

by

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Organization

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I. Introduction

> "Each member shall . . . adhere to all filings made by the National Council on its behalf with state supervisory authorities . . . "

Mr. Chairman, members of the Committee, the above language is not from some ancient, pre-Sherman Act trade association Constitution, but from the current Constitution of the National Council on Compensation Insurance (Article VII, Paragraph 3 (c)), the rate-setting organization to which all companies writing workers' compensation insurance belong. The continued existence of this anachronism is made possible by the McCarran-Ferguson Act.

Insurance is a $398 billion 1/ industry, accounting for 13% of all disposable income in the United States. In fact, Americans spend more for insurance than anything else except food and shelter. Ironically, today -- February 18 -- is the day that the average American worker has earned enough to pay his or her insurance bill. It would be fitting if today also marked the beginning of a successful Congressional effort to finally subject the insurance industry, like other industries, to free market forces, by repealing the McCarran-Ferguson antitrust exemption.

II. Background

The McCarran-Ferguson Act, enacted in 1945, exempts the insurance industry from the antitrust laws and thus allows insurance companies to fix prices. There is an exception to the exemption for

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1/ The $398 billion includes $176 billion in property/casualty premiums (Source: Best's Insurance Management Reports, Jan. 5, 1987, at 1); $156 billion in life/health premiums (Source: Actuarial Department, American Council of Life Insurers, Dec. 31, 1986); and $66 billion in Blue Cross/Blue Shield subscriptions (Source: $61.8 billion for 1984 from 1986 Source Book on Health Insurance Data, increased by a very conservative 7.5% to account for two years of price increases).

boycotts, coercion and intimidation; agreements among insurers to refuse to write insurance at any price therefore can be and have been prosecuted. E.g., St. Paul Fire & Marine Ins. Co. v. Barry, 438 U.S. 531(1978); State of West Virginia ex. rel. Brown v. St. Paul Fire & Marine Ins. Co., Civ. No. 86-C-1400, Kanawha Cty. Circ. Ct. (W. Va., filed Apr. 14, 1986); see also "Day care centers file insurance suit," The Denver Post, Jan. 17, 1986, at B-1. Oh the other hand, agreements among insurers to raise their rates in concert are immune from antitrust prosecution. In other industries such agreements are felonies punishable by three years in jail.

The McCarran-Ferguson Act was passed in 1945 in response to the Supreme Court's decision in U.S. v. South-Eastern Underwriters Association, 322 U.S. 533 (1944), which for the first time held that insurance was commerce and thus subjected insurance companies to the antitrust laws. Those laws had not previously been applied to insurance because the Court had held in Paul v. Virginia, 8 Wall 168 (1869), that insurance was not commerce, and therefore could not be regulated by Congress under the Commerce clause of the Constitution.

Ironically, the language exempting the insurance industry from the antitrust laws was included in neither the House version nor the Senate version of the McCarran-Ferguson Act, but was added in conference. 2/ That language provides that the antitrust laws "shall be applicable to the business of insurance to the extent that such

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2/ See H. Rep. No. 127, Competition in the Insurance Industry, Oversight Hearings before the House Subcommittee on Monopolies and Commercial Law, 98th Cong., 2nd Sess., at 6 (1984) (Statement of Hon. Claude Pepper).

business is not regulated by state law." 3/ In signing the bill President Roosevelt stated that "Congress did not intend to permit private rate-fixing which the antitrust act forbade, but was willing to permit actual regulation of rates by affirmative actions of the states." 4/ Nevertheless, the courts have consistently held that price-fixing by insurance companies is immunized by the McCarran Act regardless of the extent or effectiveness of a particular state's regulation of the insurance industry. 5/

III. Anticompetitive activities immunized by the McCarran Act.

A) Horizontal price-fixing

Rates in the insurance industry are often promulgated by rate bureaus -- industry-sponsored organizations which collect and disseminate cost and price information -- to which all insurance companies belong. The Insurance Services Office (ISO) collects data and promulgates rates for most lines of insurance. Unlike trucking, railroads and other regulated industries, the insurance industry does not have different rate bureaus serving different regions of the country; rather, the ISO issues rates for the entire country. Similarly, the National Council on Compensation Insurance (NCCI)

3/ 15 U.S.C. Section 1012(b).

4/ H. Rep. No. 815, 90th Cong., 1st Sess., at 22 (1967) (quoting President Roosevelt's message in connection with signing the McCarran-Ferguson Act).

5/ *E.g.*, FTC v. National Casualty Co., 357 U.S. 560 (1958); Allstate Ins. Co. v. Lanier, 361 F.2d 870 (4th Cir. 1966); California League of Independent Ins. Producers v. Aetna Casualty & Surety Co., 175 F.Supp. 857 (N.D. Cal. 1959).

promulgates workers' compensation insurance rates for the entire country.

The NCCI requires its members to adhere to its rates. Constitution of National Council on Compensation Insurance, Art. VII(3)(c). Such adherence is the classic price-fixing arrangement, the clearest type of per se violation of the antitrust laws. The ISO, on the other hand, although having required its members to adhere to its rates until the mid-1960's, now issues so called "advisory" rates, and permits its member companies to deviate from those rates. Nevertheless, the issuance of this "advisory" rate, like the circulating of a suggested price list, would also likely be per se illegal absent McCarran immunity, since it amounts to a "tampering" with prices. U.S. v. Socony Vacuum Oil Co., 310 U.S. 150, at 221 (1940); U.S. v. Nationwide Trailer Rental System, Inc., 156 F.Supp. 800 (D. Kan. 1957), aff'd per curiam, 355 U.S. 10 (1957).

The courts have consistently prohibited trade associations from circulating "suggested" price lists, even if the list serves only as a guide or starting point for price determination, and even if no agreement to adhere to the "suggested" price exists and prices to substantially depart from the "suggested" rate. Northern California Pharmaceutical Ass'n v. U. S., 306 F.2d 379 (9th Cir. 1962), cert. denied., 371 U.S. 862; Plymouth Dealers Ass'n of Northern California v. U.S., 279 F.2d 379 (9th Cir. 1969); U.S. v. Nationwide Trailer Rental System, Inc., 156 F. Supp. 800 (D. Kan. 1957), aff'd per curiam, 355 U.S. 10 (1957); see also U.S. v. National Ass'n of Real Estate Boards, 339 U.S. 485 (1950). It therefore seems fairly clear that the issuance by an industry-sponsored organization of an "advisory" rate would violate the antitrust laws absent McCarran protection, whether or not an agreement could be proved, and whether or not the members of the bureau consistently adhered to the bureau rate. See generally Esco. Corp. v. U.S., 340 F.2d 1000 (9th Cir. 1965); Dept. of Justice, The Pricing and Marketing of Insurance 167-70 (1977) (hereinafter DOJ report).

To appreciate the anticompetitive nature of ISO issuing an "advisory" rate one must understand how ISO makes rates. To determine how much to charge in the future, companies must first look to see how much they have paid in the past. 6/ That past cost data must then be "developed" and "trended," through the application of a "loss development factor" and a "trend factor." It is crucial to understand what these are:

1. The loss development factor. Rates are based on "incurred losses," which are estimates of the amount an insurer will eventually pay out on policies in effect in a given year. This estimate is derived by multiplying the amount that has actually been paid out and reserved over a certain period for claims covered by these policies by a factor based on the pattern of payouts over time on prior years' policies. This factor, which in actuarial jargon "brings the outstanding reserves to an ultimate paid basis," is called the "loss development factor."

6/ Because the more paid claims insurers can analyze the more accurate their estimates of their future payouts can be, pooling past cost data through ISO does not violate the antitrust laws, as explained more fully in the following section.

2. The trend factor. To arrive at rates to be charged in future years, insurers multiply the developed incurred loss estimates for past years (i.e., actual payouts and reserves for a certain period times the loss development factor) by a factor that estimates such effects as (a) inflation, (b) "social inflation" -- i.e., any expansion in liability rules, (c) any increase in the size of jury verdicts and (d) any increase in the rate of case filings. This factor is called the trend factor. The U.S. Department of Commerce has explained the development and trend process in somewhat more detail. This explanation is attached as Exhibit 1.

The loss development and trend factors can thus vary dramatically depending on what the individual insurance company thinks the inflation rate or the rate of case filings or the size of jury verdicts will be in the future. It is the insurance company's individual judgement with respect to those factors that is the essence of price competition in the insurance industry. And it is ISO doing the loss development and trending for the industry, more than any other single factor, that makes the current McCarran-protected rate-making regime so anticompetitive.

Moreover, before issuing an advisory rate, ISO not only develops and trends the raw past cost data; it also adds in "loss adjustment expenses" (mainly defense legal fees), a "total production cost allowance," "general expenses," "taxes, licenses and fees," and "underwriting profit and contingencies." For example, only 40% of the ISO "advisory" product liability rate is actually paid in claims; 14% goes for defense lawyers' fees, 25% goes for "total production cost allowance," 13% goes for general expenses, 3% for taxes, licenses and fees, and 5% for underwriting profit and contingencies. 7/

Most companies, however, have substantially lower expenses than those included in the ISO "advisory" rate; almost none have higher expenses. Thus, by issuing an "advisory" rate which includes expense factors based on the least efficient insurers and a profit factor which, among other things, ignores investment income, ISO both protects inefficient carriers and enables the more efficient carriers to earn supra-competitive profits.

In short, when ISO, rather than individual companies, develops and trends loss data, and adds on additional amounts for various types of expenses, profit, and "contingencies," insurers are not genuinely competing, and the market is not a free market. As the Supreme Court has put it,

> Genuine competitors * * * do not submit the details of their business to the analysis of an expert, jointly employed, and obtain from him a 'harmonized' estimate of the market as it is and, in his specially and confidentialy informed judgement, it promises to be. 8/

Absent the McCarran exemption, both the individual "competitors" engaging in such a scheme and the expert carrying it out -- the ISO -- would be violating the antitrust laws. U.S. v. Socony Vacuum Oil Co., 310 U.S. at 221 (1940); American Column Co. v. U.S., 257 U.S. at 410 (1921).

7/ Insurance Services Office, filing GL86 TPRD1 with Ohio Dept. of Insurance, Feb. 21, 1986, at Section D, Ech. 5.

8/ American Column Co. v. U.S., 257 U.S. at 410 (1921).

B) Vertical price-fixing (Resale Price Maintenance)

Insurance is the last stronghold of "fair trade" or retail price maintenance laws. State "fair trade" statutes, permitted for some years as an exception to the antitrust laws, authorized manufacturers to set the price at which their goods could be sold at retail. Under such laws, every retailer was required to take the mark-up or commission established by the manufacturer on "fair-traded" items, even if he could sell at a lower price because he was more efficient or chose a lower profit margin.

Congress repealed the general authorization for such state laws in 1975. And in 1980 the Supreme Court held that laws authorizing manufacturer determination of wholesale and retail prices for alcoholic beverages, arguably still permitted under the 21st Amendment, were pre-empted under the federal antitrust laws. 9/ Of course, private agreements setting resale prices are similarly illegal. 10/

The McCarran-Ferguson Act, however, legalizes resale price maintenance in the insurance industry. Today, most states have so-called "anti-rebate statutes," which prohibit "adjustment in premium as an inducement to buy insurance," i.e., they require each agent to charge the same commission. 11/

9/ California Retail Liquor Dealers Ass'n v. Midcal Aluminum Inc., 445 U.S. 97 (1980).

10/ Albrecht v. The Herald Co., 390 U.S. 145 (1961).

11/ Florida, however, no longer has such a requirement. Its anti-rebate statute was held to violate the due process clause of the Florida Constitution in Dept. of Ins. v. Dade County Consumer Advocate's Office, ____ Fla. ____ (June 3, 1986, No. 66, 178).

IV. Procompetitive joint activities that could continue absent McCarran immunity.

Because no company has enough claims experience of its own on which to base an accurate estimate of how much it will pay out in the future, the pooling of past cost data -- as opposed to future pricing data (i.e., trending and loss development) -- is essential in the insurance industry.

The antitrust laws do not prohibit the pooling of past cost data. To the contrary, the cases clearly establish that, unlike the exchange of future price information, the exchange of past cost data is lawful as long as the data are compiled and disseminated in composite form, deal exclusively with past and closed transactions, and are widely published and readily available to consumers. *Maple Flooring Ass'n v. U.S.*, 268 U.S. 563 at 573-74, 586 (1925); *U.S. v. FMC Corp.*, 317 F. Supp. 443, 446 (E.D. Pa. 1970); DOJ Report at 102, 116-17. ISO does not today make available to consumers the data it collects from and disseminates to insurers. It could easily do so, however; and if it did, it could continue to collect, compile and disseminate past cost data without McCarran protection. To the extent that insurers are concerned about antitrust enforcement inhibiting necessary joint data collection, we would welcome the opportunity to work together with the industry and the Committee to draft language making clear that repealing the antitrust exemption will not prohibit insurers or the public from having access to pooled past cost data.

V. The State Action Doctrine

If insurance companies fix rates or engage in other anticompetitive activity pursuant to a clearly articulated and affirmatively expressed state policy, and the state actively supervises that policy, such anticompetitive activity is immune from antitrust scrutiny under the state action doctrine. Southern Motor Carriers Rate Conference v. U.S., 105 S. Ct. 1721 (1985). Thus, even if McCarran-Ferguson is repealed, the states are free to pass laws that will allow -- or even require -- insurance companies to fix their rates or otherwise restrain competition. But with McCarran repealed the state must act affirmatively if it wants to permit insurance companies to fix prices. Today, in contrast, insurance companies may fix rates if the state does nothing.

VI. The McCarran Act and State Regulation

If McCarran-Ferguson were repealed, the states would continue to regulate the insurance industry; the federal government would not regulate the industry. Insurance companies would simply be subject to the antitrust laws like other companies. As President Roosevelt put it in January 1945, before the McCarran Act was passed, "There is no conflict between the application of the antitrust laws and effective state regulation." 12/

Interestingly, federal regulation of insurance company rates is something virtually no one seems to want. 13/ For example, in expressing a preference for state regulation over federal, insurance companies have stated that they would rather be regulated by 50 monkeys than King Kong. Similarly, former Pennsylvania Insurance Commissioner Herb Denenberg, one of the few aggressive consumer advocates to ever hold the office of insurance commissioner, told the House Judiciary Committee in 1984 that while state regulation of insurance is bad, federal regulation would be worse. 14/

Reflecting the desire to subject insurance companies to the antitrust laws while maintaining state regulation of insurance, two leading organizations of state officials -- the National Conference of State Legislatures and the National Association of Attorneys-General -- have both passed resolutions calling for McCarran repeal. We would welcome the opportunity to work with the Committee, the states and insurers to make it clear that the intent of repeal of the antitrust exemption is to strengthen, not undermine, state regulation.

12/ Letter from President Roosevelt to Senator Radcliffe, Jan. 2, 1945.

13/ *But see* note 20, *infra*, and accompanying text.

14/ H. Rep. No. 127 at 224 (1984).

VII. Regulation v. Competition

Excessive prices and supra-competitive profits may be prevented in two ways: by the free market, which is kept free by antitrust enforcement, or by regulation. In most American industries prices are not regulated: companies may charge what the market will bear, provided only that they do not act in ways that unreasonably restrain trade in violation of the antitrust laws. On the other hand, in some industries prices are regulated: trade is intentionally restrained by the government and the antitrust laws do not apply.

In some states insurance prices are regulated -- in theory, at least -- according to the second model: the antitrust laws do not apply and therefore insurers can fix prices, but those prices -- or the one fixed price -- cannot take effect until the insurance commissioner approves them. In theory such regulation works to keep rates at competitive levels because the commissioner will not approve a rate that is excessive. This type of regulation is called "prior approval."

On the other hand, in some states rates automatically take effect without being approved by the insurance commissioner. Such a regime -- misleadingly called "open competition" -- makes sense, and is pro-competitive, as long as the antitrust laws are enforced to prevent price-fixing. But today, with the McCarran-Ferguson Act enabling insurance companies to fix prices, in so-called "open competition" states there is nothing -- neither free market competition nor regulation -- to keep rates from being excessive.

Our preference is to subject insurance companies to the rules of the competitive marketplace by repealing McCarran-Ferguson and allowing so-called "open competition" rate making. Others may prefer to rely on "prior approval" rate regulation to keep rates from being excessive and to dispense with antitrust enforcement. But to have neither rate regulation nor antitrust enforcement -- as we do today in the majority of states -- gives consumers the worst of both worlds, results in excessive rates and supra-competitive profits, and makes no sense at all.

VIII. The Insurance Industry Cycle and McCarran-Ferguson

The cyclical nature of the insurance industry is today well-known. While the inelasticity of demand for insurance and fluctuations in interest rates, stock prices and exchange rates have contributed to the cycle, the industry's antitrust exemption is what makes the peaks and valleys of the cycle so extreme.

The most apparent effect of McCarran-Ferguson, of course, is the sudden, dramatic increase in insurance rates that occurs at the bottom of each cycle and thus periodically results in an "insurance crisis." For example, in January 1985, ISO apparently decided that the price-cutting of the last few years had gone far enough: ISO President Dan McNamara called a joint industry conference with the Insurance Information Institute, the industry's public relations arm, at which he emphasized that "the need for significant premium increases, especially for commercial lines, is absolute for the next three years." 15/ Then, in May 1985, ISO distributed throughout the

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15/ Business Insurance, Feb. 4, 1985, at 16.

industry a major position paper, entitled "1985: A Critical Year," which proclaimed that "the brutal price war of the last six years is over," and that "significant premium increases are needed, especially for the current commercial lines products." 16/ And the next month William O. Bailey, President of Aetna, the nation's third largest commercial liability insurer, told the National Association of Insurance Brokers that "clearly another round of price increases is absolutely necessary for the business." 17/ Then suddenly, in the summer of 1985, insurance companies that only a few months earlier had been competing on price and ignoring the ISO "advisory" rate were tripling and quadrupling their premiums, returning to the ISO rate. 18/

Equally important, although less obvious, is the effect McCarran-Ferguson has on insurance company pricing at the peaks of the insurance cycle. For the industry's antitrust immunity is largely responsible for the phenomenon of "cash-flow underwriting" -- insurers cutting insurance rates dramatically even for bad risks, solely to get premium income to invest when interest rates are high. Specifically, it is the knowledge on the part of insurance companies that, because of McCarran-Ferguson, they can get together, call a halt to price-cutting and suddenly raise their prices in concert that permits their price cutting to go so far. Because of McCarran-Ferguson, they can get back in one year what they gave away in six.

16/ ISO and NAII, "1985: A Critical Year," at 5.

17/ Business Insurance, June 10, 1985, at 3.

18/ National Underwriter, Sept. 6, 1985, at 8, 82 ("The quick reversal in underwriting standards has been shocking . . . . What has occurred . . . is a return to basic ISO rating subject to a minimum 20 percent surcharge").

The children's game of tag provides an instructive analogy. The McCarran-protected rate bureau rate functions as "home base" functions in tag. Insurers, during the competitive phase of the cycle, can ignore the bureau rate and seek market share by cutting price. The price-cuts are deeper and the duration of the price-cutting longer than would be the case in the free market because the price-cutters know that they can always return to the home base of the bureau rate. Because the bureau rate is set at a level at which the least efficient bureau member is profitable, the bureau rate will allow most insurers to earn excess profits. These excess profits attract significant capital, which sets the stage for the price-cutting to begin again.

If insurance companies competed in a free market subject to the antitrust laws, they would not be able to suddenly call a halt to price-cutting and to sharply raise their prices in concert. Moreover, the knowledge that they could not raise prices in concert after cash-flow underwriting would prevent them from engaging in such underwriting in the first place, and force them to carefully evaluate risks -- to engage in risk-based underwriting rather than cash-flow underwriting -- at all points on the cycle. Because interest rates will continue to fluctuate and demand for insurance will remain relatively inelastic, the insurance cycle will not completely disappear if McCarran antitrust immunity is eliminated. But eliminating that immunity will smooth out the cycle, and should therefore put an end to the insurance "crises" that recur every nine years or so.

IX. The Politics of McCarran-Ferguson

The intellectual argument for repeal of the antitrust exemption has long been won. The three most recent administrations have all concluded that the current broad McCarran-Ferguson antitrust immunity should be repealed. 19/ And neither Chicago school economists nor Marxist economists, nor anyone in between, defends the exemption.

The reason that Congress has not yet repealed McCarran immunity is, of course, not an intellectual but a political one. Historically, efforts to repeal McCarran have failed for three reasons:

- o Opposition from state officials, because of concern that McCarran repeal would mean the end of state insurance regulation;
- o lack of a critical mass of interest groups that favor repeal; and
- o the intransigence of the insurance lobby.

Today, however, the National Conference of State Legislatures and the National Association of Attorneys-General have both called for repeal of the Act. And businesses, consumer groups, women's and other civil rights organizations, environmental groups and others, as well as the states, are coming together to work for repeal of the antitrust exemption.

19/ See DOJ Report; Report to the President and the Attorney-General of the National Commission for the Review of Antitrust Laws and Procedures, Jan. 22, 1979, at 225; Oliver, "Risky Business: Repealing McCarran-Ferguson, and Other Heresies," Dec. 10, 1986 (Statement of FTC Chairman Dan Oliver before the NAIC).

Finally, the insurance industry -- or at least some segments of it -- no longer seems as intransigent as it once was. For example, the new president of the American Insurance Association recently told the Journal of Commerce that the industry would probably be willing to give up its antitrust immunity in exchange for continued state regulation; State Farm for several years now has been circulating its own proposal to change the McCarran Act, and calls the antitrust exemption "the Achilles Heel of state regulation"; some insurers have gone even further and called for federal regulation of insurance; 20/ and the life/health industry, while adamently opposed to allowing the FTC to study insurance, is not nearly so concerned about its antitrust immunity because it does not act collectively to nearly the same extent as do property/casualty insurers.

Mr. Chairman, insurance companies have nothing to fear from the repeal of the McCarran-Ferguson antitrust exemption. We understand and share their concern that state regulation and joint data collection be maintained. We would welcome the opportunity to work with the industry, Congress and other interested parties to develop legislative language to assure that outcome.

20/ Former Insurance Company of North America (INA) president John Cox, for example, says that state regulation "has gotten out of hand," and that the industry "must have a federal option." National Underwriter, March 21, 1986, at 3.

From U.S. Dept. of Commerce Task Force on Product Liability and Accident Compensation, Report on Product Liability Insurance Ratemaking, at 100 (1980)

Exhibit 1

For example, in using policy year 1975 losses to assist in determining BI rates effective January 1, 1982, these losses must first be developed to ultimate. This is accomplished by multiplying the 1975 losses by the corresponding development factor, 1.781, as shown in Exhibit A-3. Also, the unallocated loss adjustment factor--1.085--must be applied. The result represents the losses that will ultimately be paid for policy year 1975.

Next, the fully developed 1975 losses must be projected into the future to determine what their magnitude would be if they occurred in policy year 1982. In making this determination, it is assumed that policies are written and losses occur evenly throughout each policy year. Thus, for policy year 1975 the average date of occurrence (i.e., loss) is midway between January 1, 1975 and December 31, 1976, or January 1, 1976. Similarly, for policy year 1982, the average date of occurrence (i.e., loss) will be January 1, 1983. Thus, the developed policy year 1975 losses must be projected from the average date of their occurrence--January 1, 1976--to the average date of occurrence for policy year 1982--January 1, 1983. The projection is made by exponentially raising the trend factor (e.g., 1.140) by an amount equal to the number of years into the future for which a projection is to be made. This result is multiplied by the 1975 incurred losses (determined with loss development and unallocated loss development factors), to yield projected losses (based on policy year 1975 data) for policy year 1982.

Thus, in our illustration, the projection of 1975 losses to 1982 losses will be made as follows:

$$\text{1982 losses} = \begin{pmatrix}\text{1975}\\ \text{losses}\end{pmatrix} * \begin{pmatrix}\text{loss develop-}\\ \text{ment factor}\end{pmatrix} * \begin{pmatrix}\text{unallocated loss adjust-}\\ \text{ment expense factor}\end{pmatrix} * (\text{trend factor})^{(\text{number of years of projection})}$$

$$\text{1982 losses} = (\text{1975 losses})*(1.781)*(1.085)*(1.140)^{7**}$$

This methodology is repeated for each year that will be taken into account.

** For purposes of simplicity, a trend factor of 14 percent is assumed to be in effect throughout the 7-year period. If the actual factors on Exhibit C-1 are used--1.145 prior to October 1, 1978, and 1.140 subsequent thereto--the expression will not be $(1.140)^{7}$ but $(1.145)^{2.75}$ * $(1.140)^{4.25}$.

NATIONAL INSURANCE
CONSUMER ORGANIZATION

March 25, 1987

Honorable Joseph R. Biden
Chairman
Senate Judiciary Committee
U. S. Senate
Washington, D. C. 20510

Dear Mr. Chairman:

Thank you for your letter of February 25. Enclosed are the answers to the questions you pose.

Question 1. The tort policy working group reviewed a number of industries and found that insurance was becoming increasingly unavailable. For example, biotechnology companies are having a difficult time in the insurance market because they are new, small companies dealing mostly in research and development in a field largely unknown to insurers. Many of our basic industries, such as oil, gas drilling and heavy manufacturing are hard pressed to find insurance at a reasonable cost as well. Is this a manufactured crisis? If so, by whom?

Answer 1. The insurance crisis -- sudden, dramatic rate increases and refusals to deal by insurance companies -- is real. It is the insurance industry's explanation for the crisis -- a purported litigation explosion -- that is manufactured. See, e.g., National Center for State Courts, A Preliminary Examination of Available Civil and Criminal Trend Data in State Trial Courts for 1978, 1981 and 1984 (April 1986); "Focusing on the Facts of the Insurance Crisis," a Report to the House Subcommittee on Economic Stabilization, by Phillip J. Hermann, Chairman of the Board, Jury Verdict Research, Inc., August 6, 1986 (JVR studies "do not support any claim of recently escalating jury awards").

The true cause of the recent insurance crisis, and a similar crisis in 1975-76, is the cyclicality of the insurance industry. Insurance rates rose dramatically in 1985-86, just as they did in 1976-77, because the insurance industry's rate of return bottomed out at about 3% in 1984 just as it had in 1975. 1/

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Explanations for the cycle vary. The most frequently cited is that the profitability of the industry tracks interest rates. When interest rates are high insurers earn high returns on the premiums they collect, their profitability rises and they begin cutting prices; when interest rates are low they earn low returns on their premiums, their profitability falls and they must raise prices. 2/ Other factors also contribute to the insurance cycle: the inelastic nature of demand for insurance; statutory barriers to entry (e.g., laws prohibiting banks from entering the insurance industry); fluctuations in exchange rates, which substantially affect the supply of reinsurance -- insurance for insurance companies -- since the reinsurance market is dominated by foreign firms; and stock prices, since although most property/casualty insurance company funds are in bonds, about 20% is in common stocks. 3/

More important than all factors but the fluctuation in interest rates, however, is the insurance industry's exemption from the antitrust laws under the McCarran-Ferguson Act. The relationship between the antitrust exemption and the insurance cycle is explained in the answer to Question 2.

Question 2. Is the insurance crisis particularly related to the insurance industry's exemption from the federal antitrust laws or federal regulation in general?

Answer 2. The insurance crisis is related to the insurance industry's exemption from the antitrust laws.

First, the antitrust exemption allows insurance companies to suddenly and dramatically raise rates in concert at the bottom of each cycle. For example, in January 1985, the Insurance Services Office apparently decided that the price-cutting of the last few years had gone far enough: ISO President Dan McNamara called a joint industry conference with the Insurance Information Institute, the industry's public relations arm, at which he emphasized that "the need for significant premium increases, especially for commercial lines, is absolute for the next three years." 4/ Then, in May 1985, ISO distributed throughout the industry a major position paper, entitled "1985: A Critical Year," which proclaimed that "the brutal price war of the last six years is over," and that "significant premium increases are needed, especially for the current commercial lines products." 5/ And the next month William O. Bailey, President of Aetna, the nation's third largest commercial liability insurer, told the National Association of Insurance Brokers that "Clearly another round of price increases is absolutely necessary for the business." 6/ Then suddenly, in the summer of 1985, insurance companies that only a few months earlier had been competing on price and ignoring the ISO "advisory" rate were tripling and quadrupling their premiums, returning to the ISO rate. 7/

Because the courts have consistently prohibited trade associations from circulating "suggested" price lists, even if the list serves only as a guide or starting point for price determination, ISO could probably not issue an advisory rate absent antitrust immunity. See Northern California Pharmecutical Ass'n v. U.S., 306 F.2d 379 (9th Cir. 1962), cert. denied., 371 U.S. 862; Plymouth Dealers Ass'n of Northern California v. U.S. 279 F.2d 379 (9th Cir. 1969); U.S. v. Nationwide Trailer Rental System, Inc., 156 F. Supp. 800 (D. Kan. 1957), aff'd per curiam, 355 U.S. 10 (1957); Esco. Corp. v. U.S., 340 F.2d 1000 (9th Cir. 1965); Dept. of Justice, The Pricing and Marketing of Insurance 167-70 (1977). And absent antitrust immunity, ISO and insurance company executives would certainly be less likely to urge other insurance executives to raise their prices.

Second, the antitrust exemption encourages pricing below cost when interest rates are high. It is the knowledge on the part of insurance companies that, because of McCarran-Ferguson, they can get together, call a halt to price-cutting and suddenly raise their prices in concert to excessive price levels that permits their price cutting to go so far. Because of McCarran-Ferguson, they can get back in one year what they gave away in six.

The children's game of tag provides an instructive analogy. The McCarran-protected rate bureau rate functions as "home base" functions in tag. Insurers, during the competitive phase of the cycle, can ignore the bureau rate and seek market share by cutting price. The price-cuts are deeper and the duration of the price-cutting longer than would be the case in the free market because the price-cutters know that they can always return to the home base of the bureau rate. Because the bureau rate is set at a level at which the least efficient bureau member is profitable, the bureau rate will allow most insurers to earn excess profits. These excess profits attract capital, which sets the stage for the price-cutting to begin again.

If insurance companies competed in a free market subject to the antitrust laws, they would not be able to suddenly call a halt to price-cutting and to sharply raise their prices in concert. Moreover, the knowledge that they could not raise prices in concert after "cashflow" underwriting would prevent them from engaging in such underwriting in the first place, and force them to carefully evaluate risks at all points on the cycle. Because interest rates will continue to fluctuate and demand for insurance will remain relatively inelastic, the insurance cycle will not completely disappear if McCarran antitrust immunity is eliminated. But eliminating that immunity will smooth out the cycle , and should therefore put an end to the insurance "crises" that recur every nine years or so.

Question 3. A number of experts, including those who participated in both the 1977 and 1979 Justice Department studies, have concluded that this industry is competitively structured, even if individual companies do not behave competively in the context of the industry's regulatory environment. Why is repeal of McCarran-Ferguson so critical to enhanced competitiveness in the industry? Wouldn't it be enough if the states enacted tougher unfair trade or antitrust laws applicable to the industry?

Answer 3. Repeal of McCarran-Ferguson antitrust immunity is critical to enhanced competitiveness because it is the antitrust immunity which allows the competitively structured insurance industry to perform in an anticompetitive manner, as explained in the answer to question 2.

The states have not applied state antitrust laws to the insurance industry and in general have not enacted tough unfair trade laws that are applicable to the insurance industry. Moreover, as was evident from the testimony of the West Virginia Attorney-General, individual states simply do not have the resources to prosecute the insurance industry under "little FTC Acts" or "little Sherman Acts" even if they did apply to the insurance industry. As New Jersey ~~I~~nsurance Commissioner Ken Merin has put it, the states are simply "outmanned and outgunned" by the insurance industry. 8/ There are also those who argue, including the U.S. General Accounting Office, that state insurance commissioners often do not have what the GAO called an "arms-length relationship " with the insurance industry. 9/

Question 4. The consumer groups have testified that they favor the repeal of the exemption from the federal antitrust laws that the insurance industry enjoys under McCarran-Ferguson. However, such legislative action has often been linked with proposals for increased federal regulation of the insurance industry -- ideas such as the establishment of a federal insurance agency to review state regulation. That is a much more complicated position. Is such regulation necessary if McCarran-Ferguson is repealed?

Answer 4. No. We support repeal of the antitrust exemption for the insurance industry contained in the McCarran-Ferguson Act and the maintenance and strengthening of the national commitment to state regulation of the insurance industry.

We applaude Senator Metzenbaum's public statement that he will amend S. 80 so that it would repeal only the anti-trust exemption while maintaining and strengthening state regulation. The debate must focus on the appropriate question -- do insurance companies need to be able to fix prices? -- rather than the red herring of state versus federal regulation. With the elimination of the antitrust exemption, states could choose to deregulate and would be assured that deregulation would not lead to anticompetive behavior. On the other hand, states that chose to regulate prices would remain free to do so, under the state action doctrine.

Question 5. Would it be logical to subject insurance companies to liability under federal antitrust law without comprehensive federal regulation of the industry as a whole?

Answer 5. Yes. State-chartered banks, for example, are subject to antitrust law but are not federally regulated.

Question 6. The insurance industry argues that restricting or repealing McCarran-Ferguson would lead to great uncertainty as to what kinds of collective activities would be permissible. For example, what kinds of data would companies be able to share, or would they be able to do this at all? Would they be able to pool risks and establish joint ventures to obtain reinsurance? Aren't these legitimate concerns? How would you propose to establish some legal certainty without years of litigation?

Answer 6. The antitrust laws do not prohibit the pooling of past cost data. To the contrary, the cases clearly establish that the exchange of past cost data is lawful as long as the data are compiled and disseminated in composite form, deal exclusively with past and closed transactions, and are widely published and readily available to consumers. Maple Flooring Ass'n v. U.S., 268 U.S. 563 at 573-74, 586 (1925);U.S. v. FMC Corp., 317 F. Supp. 443, 446 (E.D. Pa. 1970); Department of Justice, The Pricing and Marketing of Insurance at 102, 116-17.

In contrast, the pooling of future pricing data clearly is prohibited by the antitrust laws.

The legality of the pooling of risks and the establishment of joint ventures to obtain reinsurance would be governed by the rule of reason. For example, an agreement among the only three insurers writing a line of business to pool that business would not normally be pro-competitive and thus would not pass muster under the rule of reason. On the other hand, a pooling agreement among several small insurers attempting to enter that same three-firm market would normally be pro-competitive, and thus legal under the rule of reason.

To the extent that insurers truly believe that the rule of reason gives them insufficient guidance as to which activities are lawful and which unlawful, Congress could write carefully drafted standards codifying the rule of reason into the law, as it did with the limited immunity for research and development joint ventures enacted in the 98th Congress.

Question 7. If the Judiciary Committee were to act on this kind of legislation, wouldn't we be wiser to consider a more limited and well-defined immunity from the antitrust laws than an outright repeal of McCarran-Ferguson? Wouldn't the uncertainty that might otherwise be created actually harm consumers and make at least some kinds of insurance even harder and more expensive to obtain?

Answer 7. We support, and believe the Judiciary Committee should support, a repeal of the antitrust immunity granted by the McCarran-Ferguson Act rather than a repeal of the entire McCarran-Ferguson Act. To the extent Congress is concerned that repealing the antitrust exemption would create uncertainty that would harm consumers, Congress could write specific standards into the law. (We fail to see, however, how subjecting the insurance industry to the antitrust laws could harm consumers. We are certain that the current situation harms consumers by protecting inefficient anti-competitive behavior which costs consumers billions of dollars in inefficiencies.)

Question 8. What kinds of exceptions would consumer groups be willing to support?

Answer 8. While we do not believe that exceptions are necessary, neither do we believe that expressly permitting insurance companies to jointly collect, compile and disseminate past cost data is harmful. In addition, we believe Congress should give the insurance industry every opportunity to make its case that additional exemptions are needed, and we would welcome the opportunity to discuss with your Committee and the industry the need for any specific exemptions for which your Committee felt the industry had made a *prima facie* case.

Sincerely,

J Robert Hunter

J. Robert Hunter
President

Jay Angoff,
Counsel

FOOTNOTES

1/ Insurance Information Institute, Insurance Facts: 1986-87 Property/Casualty Fact Book, at 22; Insurance Information Institute, Insurance Facts: 1982-83 Edition, at 19.

2/ E. G., "Insurers Must Take Part of the Rap," Business Week, March 10, 1986.

3/ Insurance Information Institute, Insurance Facts: 1986-87 Property/Casualty Fact Book, at 23.

4/ Business Insurance, Feb. 4, 1986, at 16.

5/ ISO and NAII, "1985: A Critical Year," at 5.

6/ Business Insurance, June 10, 1985 at 3.

7/ National Underwriter, Sept. 6, 1985, at 8, 82 ("The quick reversal in underwriting standards has been shocking . . . . What has occurred . . . . is a return to the basic ISO rating subject to a minimum 20 percent surcharge.")

8/ Journal of Commerce, July 8, 1986, at 1.

9/ See U. S. General Accounting Office, Issues and Needed Improvements in State Regulation of the Insurance Business (Oct. 1979).

Senator **Metzenbaum**. Mr. Hunter, is my recollection right that you were an insurance commissioner yourself at one time?

Mr. **Hunter**. I was the Federal Insurance Administrator.

Senator **Metzenbaum**. You were the Federal administrator. Thank you.

John Satagaj, President of the Small Business Legislative Council.

Mr. **Satagaj**. Thank you, Mr. Chairman. It is a pleasure to be here today. As you know, we have long been an advocate of vigorous antitrust enforcement and we look forward to working with you on a host of other issues as well.

SBLC is an independent, permanent coalition of 90 trade and professional associations who share a common interest in the future of small business. Together, we represent the interests of over 4 million small businesses in nearly every economic sector.

You have our written statement for the record. Let me emphasize four points. This hearing is a timely one, as my organization just completed its annual meeting one week ago, and the subject of regulation of the insurance industry came up as our number five priority.

First, let me say that small business is the man caught in the middle of this crisis. We have suffered from the roller coaster ride of the affordability-availability crisis. We recognize the problem is multi-faceted and the solutions must be equal to the task. The bottom line, however, for the small business person is that we do achieve results.

Second, we are concerned about the quality of regulation of the insurance industry. The concept of Federal regulation does not thrill the small business community and we prefer State regulation. However, the insurance industry is interstate, if not global in nature. We need to ensure that we have the resources, wherever they are located, to protect the public and the small business community. To the extent that McCarran-Ferguson is part of that problem, we must resolve it.

Three, we are uncertain, and judicial precedent seems to bear this out, about the true scope of the antitrust exemption included in McCarran-Ferguson, and there are many questions regarding the range of protection under boycotts, coercive activity, and so forth.

We would like to resolve that matter once and for all, and we believe the best way is to start from the beginning. I think it was an earlier witness who mentioned that perhaps what we need to do is to define the individual activities that we would like to protect and proceed from that point of view rather than trying to exempt an entire industry and a patchwork quilt of activities.

In this regard, for example, we do recognize the need for joint loss data collection, and we believe that's an important exemption. In particular small insurers need that type of exemption. So we want to build on the individual activities rather than a wholesale exemption.

Fourth, competition is the hallmark of small business. We understand it is the stakes for playing in the game and we want competition in this industry. We also understand that insurance is not a luxury, but a necessity to do business, and we hope regulation will ensure that small business can continue to do just that, continue in business of creating jobs and innovating.

That concludes my remarks. I am pleased to be here today and will take any questions you have, Mr. Chairman.

[Prepared statement follows:]

TESTIMONY OF

John S. Satagaj
President

Small Business Legislative Council

My name is John S. Satagaj and I serve as President of the Small Business Legislative Council (SBLC). The SBLC is a permanent, independent coalition of ninety professional and trade associations who share a common interest in the future of small business. Our members represent nearly every sector of the economy including manufacturing, wholesale, retail, construction, service and agriculture and the SBLC's member associations represent over four million small businesses.

First, we are pleased that the Senate has reestablished this important subcommittee and that you have been selected to preside. In its ten years as a coalition, SBLC has taken a keen interest in antitrust matters and we believe we have access to some of the finest small business antitrust experts in the country. We firmly believe it is time to take a close look at the current concentration of economic power in this country and the long term impact of recent corporate merger and acquisition activity. We are concerned for the future of small business, particularly the growing firms who must compete head to head with the major firms, or who must rely on these major firms for goods and services. We look forward to working with you on these matters.

We are here today to discuss the impact of the McCarran-Ferguson Act on small business. This is a timely hearing as we have just completed our 1987 issues conference one week ago. At that meeting the members of the SBLC met to select our priorities for the 100th Congress. It should not be a surprise to anyone to learn that the issue of insurance regulation emerged as Recommendation Five on our list of priorities. Before presenting our recommendation, let me step back a moment from our recommendation to establish a framework for our efforts.

We believe Congress must consider two aspects when examining the impact of McCarran-Ferguson Act on small business. First, much of our concern is driven by what we call the tort reform/insurance regulation crisis, a crisis which appears to be easing as insurance companies recover from the low point of the recent cash flow underwriting cycle. The easing of the affordability/availability crisis should not be an excuse to delay reform.

We hope we can learn some lessons from the crisis and that we can improve the civil justice and insurance regulation systems. Our goal is to ensure that small business is never caught in the middle again. We have yet to see any evidence that small business was responsible for the crisis, yet we were on the front line of those who suffered the consequences.

In 1985 and 1986, the SBLC held two major conferences specifically on the crisis. Many of our member associations conducted surveys of their membership on the subject of insurance coverage. Not surprisingly, the returns indicated astronomical rate increases and some reduction in availability. At the same time, the surveys turned up very little evidence of an increase in claims against these small firms. To us, this data is now old news. We hope the public and Congress is already convinced of the seriousness of the crisis and the institutional flaws that caused it. We believe it is now time to act. We have already lost much momentum.

At the 1986 White House Conference on Small Business, the number one recommendation was a comprehensive statement on the tort reform/liability insurance crisis. The recommendation acknowledged the fact that the crisis is a multifaceted problem requiring action in several different areas this year. The three major components of a comprehensive solution are reform of the civil justice system, enactment of a federal product liability bill and closer scrutiny of insurance industry regulation. In 1986, much of the federal activity was focused on tort reform and product liability. A number of States enacted significant civil justice reforms and a national product liability bill made it to the floor of the Senate. Insurance regulation was placed on the back burner. We hope we will see action in all these areas.

Specifically, the White House Conference Recommendation made the following suggestions with regard to the insurance industry:

1. Review McCarran-Ferguson Act of 1945 as it applies to state regulation of insurance and the industry's limited exemption from antitrust laws.

2. Promote the establishment of joint underwriting associations and assigned risk pools.

3. A minimum of 60 days notice should be required if an insurer decides not to renew a policy or to increase its unit premium by more than 25 percent. Mid-term cancellations should be prohibited and premiums should be based on experience ratings.

4. Promote tax-deductible self-insurance through risk pooling and other group arrangements, including the expansion of the Risk Retention Act of 1981.

5. Legislate a self-insurance system that would allow small businesses to pay premiums into a fund with pre-tax dollars. The fund could be used for no other purpose than the payment of claims, with the fund being regulated in the same manner as any other insurance company.

6. Require the insurance industry to make complete financial disclosures by lines of insurance, so that Congress, state legislatures, and state insurance commissioners may call on this information at any time.

The foundation for the policy position of the White House Conference recommendation was the desire of small business to achieve one goal--to ensure the availability of affordable insurance. It is fair to say that it is not so much how we achieve this goal, but that we do, indeed, achieve it. The White House Conference recommendation acknowledges it will take action in each of the major policy areas to insure a lasting, stable insurance environment.

We recognize that repeal or revision of McCarran-Ferguson will not, by itself, result in a stable insurance environment. We do feel, however, that a comprehensive solution requires closer scrutiny of the law. We believe the insurance industry has a legitimate need for joint collection and evaluation of loss data. This appears to be a particularly important concern for small insurers and we understand the dilemma which they face. Therefore, we anticipate the need to continue some joint activity by insurance companies.

Second, we know that, by and large, federal regulation as a concept does not sit well with small business. States are closer to the consumer and do have the potential for being more responsive to their needs. The fact of the matter is, however, that the insurance business is global in nature, and as with any such industry, management and administration have become extremely sophisticated and complex. One must ask the question whether any one state can effectively regulate the industry even if the state had unlimited resources.

Our goal is to ensure the establishment of a regulatory environment which is equal to the task. Arguments can be made about the regulated status of the insurance industry versus other industries, or the fact state regulation "has worked so well for so long". The truth is, insurance has become too integral a part of our society, and too essential a necessity for doing business. Given that reality, we may no longer be able to justify the current approach to insurance regulation. Historical reasons for the creation of the current system must be given due deference, but the sacred cows may have to be put on the auction block to save the consumer and small business owner.

The other aspect of a review of the McCarran-Ferguson act is whether there is any justification for its continuation from a purely antitrust point of view. The first question any small business owner asks, why should anybody have an antitrust exemption? Competition is the name of the game for small business. As long as it is a fair fight, small business accepts competition as the stakes to join the game.

What does the antitrust exemption include? It has been said that judicial activity through the years has greatly narrowed the scope of the exemption and that the government already has the authority to investigate activities such as boycotts. If that is the case, than repeal should not trouble proponents of the McCarran-Ferguson Act. Let us clear up the law and say what we mean. From what I understand of the legislative history of McCarran-Ferguson, it is not likely Congress anticipated the vast and diverse body of judicial precedent which would accumulate around McCarran-Ferguson. Furthermore, we have the benefit of forty years experience. Let us draw on that experience and craft an exempt, if it is necessary, which reflects specific needs such as data collection.

It is on this backdrop we have made the following recommendation at our annual meeting held on February 11th:

> The ability to obtain casualty insurance at reasonable, affordable prices continues to be a problem faced by small businesses and individuals throughout the nation.
>
> The current crisis is a recurrent characteristic of the insurance industry manifested about every eight to ten years. The present crisis may linger longer in the crisis phase than has been true in past cycles.
>
> The costs surges and non-availability of certain lines of insurance follow periods of highly competitive, possibility predatory behavior of the insurers in seeking premium dollars for investments, especially during periods of high returns on capital. These cyclic periods of below-cost sales of insurance products (termed cash flow underwriting) appear to be repetitive, irrational behavior.
>
> Regardless of where blame may properly rest, this current crisis has resulted in severe losses to certain elements of the insurance industry in addition to thousands of insureds, particularly small businesses, depending upon this product, have experienced price shock and unavailability of insurance.
>
> The cyclic behavior, the absence of any national oversight, and the dearth of data suggest the need for federal examination and study of the insurance industry.
>
> Effective state regulation of these national and international corporations cannot be accomplished without improved centralized data-gathering from which state regulators and legislatures can obtain meaningful information needed to regulate the insurers.

Both federal and state antitrust principals must be applied to the extent possible in judging the behavior of the insurance industry. The scope of the McCarran-Ferguson antitrust exemption for the insurance industry must be carefully reexamined. Small business recognizes, however, the need, particularly for small insurers, to have available adequate data to compete. The Federal Trade Commission should again be authorized to study and investigate the activities of this essential industry.

The main concern of small business is the ensure the continuous availability of competitively priced insurance through the stability and solvency in the insurance industry. A federal centralizes data activity which can assist the states to effectively regulate the business of insurance or state promulgated regulations, prohibiting insurers from directing insureds to specific providers of goods and services except upon written requests of insured, are examples of actions which will achieve such goals.

Any step which will ensure a stable insurance market for small business will be a step in the right direction. In our opinion, action on McCarran-Ferguson related issues is one such step. Thank you for your time and attention.

Senator **Metzenbaum**. Thank you very much.

Mr. Cooper.

Mr. **Cooper**. Thank you, Mr. Chairman.

Senator **Metzenbaum**. Mr. Cooper represents the Consumer Federation of America.

Mr. **Cooper**. When last the Federal Government looked at the life insurance industry, it did not see a pretty picture. It concluded that returns paid on the investment components of life insurance were abyssmal. Products embodied unannounced features that undermined their economic value, and ineffective competition resulted in a wide disparity of rates paid to consumers on the investment component. The FTC estimated that $3.7 billion in 1977 would be saved by consumers if the industry paid only 4 percent.

Recently, the Consumer Federation took another look at the life insurance industry, since the Federal Government is not allowed to. We contacted over 200 agents in an attempt to start the process of actually buying a life insurance policy.

We found essentially the same distasteful picture that the FTC found several years ago. We observed a wide variation in interest-adjusted net cost. We found that life insurance agents market complex products, but they refuse to provide consumers with simple, sensible information. If a consumer asks for basic information over the phone or through the mails, he cannot get it.

Only a fifth of the agents would talk about the interest-adjusted net cost index, which is the industry standard. Less than a third mailed us enough information so that we could evaluate the cost of the policy.

We estimated that consumers could save between 5 and $10 billion per year. Things have not gotten any better since the FTC studied the industry.

By withholding information and insisting on face-to-face meetings, agents have immense leverage over consumers. Such a meeting imposes a high cost on consumers, forcing them to invest a great deal of time. Without prior information, it places consumers at a serious disadvantage by confronting them with complex choices in the presence of a so-called expert and this renders them vulnerable to pressure tactics.

Agent sales practices were intended to inhibit comparison shopping and, in some cases, were downright deceptive. Agents go so far as to ask if you are going to comparison-shop and refuse to give you information if you say you are.

I believe that such action, with a properly documented case, would be actionable under normal Federal law, but would not be actionable under the laws applied to the insurance industry.

Agents claim that there is a 1- or 2-percent difference in costs, but we found 200-percent differences. Again, if a proper case were put together demonstrating a consistent pattern of such behavior, this would be actionable under normal Federal law, but not under the law applied to the insurance.

Agents also exhibit a strong sense of territoriality. Again, if the Department of Justice or Federal Trade Commission were to uncover a consistent pattern of such territoriality, it could, in fact, bring a case under normal antitrust law.

To some, price variability in the industry is simply indicative of individualized purchases of complex contractual commodities. While there is certain to be some variability in price where differences in need exist, the code of silence in the industry is inexcusable.

By forcing consumers to decide in relative ignorance, the industry enhances its power over consumers. It gains the ability to impose unjustified costs and to engage in unjustified anti-competitive price discrimination.

These practices that we encountered in the marketplace are anticompetitive and they should be subject to the threat of vigorous Federal antitrust oversight.

Thank you.

[Prepared statement follows:]

TESTIMONY OF
DR. MARK N. COOPER
DIRECTOR OF RESEARCH
CONSUMER FEDERATION OF AMERICA

Mr. Chairman and Members of the Committee,

My name is Dr. Mark N. Cooper. I am Research Director of the Consumer Federation of America with offices at 1424 16th Street, N.W., Washington, D.C. 20036.

The Consumer Federation of America (CFA), founded in 1968, is the nation's largest consumer advocacy organization with membership encompassing more than 200 national, state and local groups. CFA's purpose is to represent consumer interests before Congress and the federal agencies. We greatly appreciate the opportunity to appear before the Committee to share our concerns about the antitrust exemption enjoyed by the insurance industry.

In my remarks today I will report on recent research undertaken by the Consumer Federation into the sales practices of the life insurance industry -- a full report has been submitted for the record. Our experience in attempting to buy insurance makes it clear that these exemptions are helping to sustain practices that impose massive costs on consumers.

When last the Federal government looked at the life insurance industry, it did not see a pretty picture. It concluded that

> returns paid on the investment components of life insurance were abysmal,
>
> products embodied "unannounced" features that undermined their economic value and
>
> ineffective competition resulted in wide disparities in returns paid to consumers.

The insurance industry, outraged by these findings, mounted a successful campaign to prevent the Federal Trade Commission, which conducted the 1979 study, from looking into the industry further. Others who have evaluated insurance policies since have reached similar conclusions.

Recently, the Consumer Federation took another look at the life insurance industry from a somewhat different point of view. We contacted over two hundred agents in an attempt to initiate the process of purchasing a life insurance policy. We found essentially the same distasteful picture that the FTC did.

> We observe a wide variation in interest adjusted net cost. The ten year cost of term policies varies from $1.48 per thousand dollars of insurance to $3.73 per thousand. For whole life policies the range is from a negative $4.71 per thousand to a positive $1.62.
>
> Compared to a good term policy, the new wave "universal policies" are quite expensive. Our 25 year old consumer would be between $2,000 and $4,000 better off over a twenty year period if he purchased term insurance and earned a relatively low interest rate on what he saved in premiums.

The FTC concluded that

> we estimate that consumers would have had an additional $3.7 billion in 1977 alone if the life insurance industry paid only 4 percent on savings."

In our report we estimated the potential cost savings to consumers in the range of $5 to $10 billion per year. We derived our estimate by evaluating the "new wave" universal policies received in the mail in a framework that used an underlying interest rate of 4 to 4.5 percent, almost identical to that which the FTC used. With inflation and the increase in life insurance in force, our estimate works out to almost a direct extrapolation of the FTC number, even though it was arrived at in an entirely different manner.

Our conversations with agents and analysis of policy costs indicate three sources of such potential consumer savings:

> high commissions on non-term policies,
>
> excessive insurance costs embedded in universal policies,
>
> and inferior returns on the investment component.

Not only did we find potential cost savings that were almost identical, on a relative basis, to those found by the FTC, but we also think our approach points to the cause of the problem. Life insurance agents market complex products but they refuse to provide consumers with simple, sensible information.

If a consumer asks for basic information over the phone or through the mails, he or she has a great deal of difficulty obtaining it.

> Only 56 percent of the agents were willing to discuss exactly the policy about which the consumer inquired.
>
> Only a fifth of the agents were willing to provide the Interest Adjusted Net Cost Index, which is the standard cost measure for insurance policies.
>
> A third of all agents simply refuse to discuss cost in any form.
>
> Less than one third of the agents sent enough information for the consumer to actually be able to estimate the cost of the policy and compare it to other policies.

By withholding information and insisting on a face-to-face meeting, agents gain immense leverage over consumers.

> Such a meeting imposes a high cost on consumers in terms of time spent (it raises search costs).
>
> Without prior information, it place consumers at a serious disadvantage by confronting them with complex choices in the presence of an "expert," which renders them vulnerable to pressure tactics.

Agent sales practices were intended to inhibit comparison shopping and in some cases were downright deceptive.

> Agents go so far as to ask the consumer if he were planning to comparison shop and refused to send the information if he said yes.
>
> In many cases, before they mailed out their policy illustrations, they tore off the pages that provide the most useful cost information for consumers.
>
> Agents claim that there is one or two percent difference in costs, but we found differences as large as 200 percent.
>
> Agents disparage assumptions about interest rates for purposes of cost comparison, then they turn around and try to sell their own assumptions.
>
> Agents also exhibit a strong sense of territorial exclusivity.

How do such clearly anticompetitive practices persist in the industry? Consumer advocates have long argued that barriers to entry imposed by law, price fixing and market sharing arrangements that are legal, but ineffectively regulated, and antitrust immunities combine to allow business practices that would not persist in a fully competitive market. The results of our study indicate the urgency of repealing or modifying a number of exemptions from federal oversight which the industry enjoys.

To some, price variability in the industry is simply indicative of individualized purchases of complex, contractual commodities. While there is certain to be variability in price where different needs exist, the code of silence in the industry is inexcusable. By forcing consumers to decide in relative ignorance, the industry enhances its power over consumers and gains the ability to impose unjustified costs and excessive price discrimination.

These anticompetitive practices and unjustified costs could not exist if they were not protected from close scrutiny by special exemptions granted to the industry.

Senator **Metzenbaum**. Dr. Seldin, representing the American Dental Association.

Dr. **Seldin**. Thank you, Mr. Chairman. I am Leslie W. Seldin. I am a practicing general dentist in New York City, President of the Dental Society of the State of New York, and Vice Chairman of the ADA's Council on Insurance.

In representing the 145,000 dentists in this country, we do not come before you as experts in antitrust law or with a set of specific and definite recommendations for legislative change. We hope that by relating our problems and our needs, perhaps it will add something to your deliberations.

The professional liability crisis of the 1980s has altered the attitude of every dental practitioner in this country. Six hundred-percent average premium increases in the last 2 years have led to a reevaluation of the economy of dental practice and the manner in which care is provided to the public.

Our oral surgeons, whose average premiums now reach $24,000 across this country and have reached as high as $95,000 in areas of Florida, are now beginning to abandon practice. These premiums act as a barrier for new practitioners who seek to go into this area of practice.

A change in the manner in which the insurance industry is regulated will not affect the precipitous increase in frequency and severity in professional liability claims suffered by the professions.

However, if insurance industries were forced to better justify and delineate the manner in which they design and rate their professional liability risks, the dental profession, among others, would be better able to identify problem areas of practice and attempt to improve the profession's attention to these modes of practice, thus assuring the consumer patient better care.

I would like to make three points to you today, Senators. Although carriers claim full disclosure of pertinent data through rate filings, these statistics are limited to information which is broad in nature and does not allow meaningful analysis which might lead to better design and more equitable rating of our professional liability programs.

While these rate filings satisfy the State insurance commissioners, they do not allow the corrections in practice attitudes which would benefit the dentists and the public they serve.

It is evident that this enormous body of information developed about the dental profession is in the computer banks of the insurance carriers, but they are resistant to releasing this information to the professions.

Second, another interesting development is the alteration and the reduction of coverages available to dental practitioners. In unilateral actions, insurance carriers have limited availability of coverage to segments of our profession with no supportable actuarial basis.

The most glaring example of this is the exclusion from coverage of procedures in which general anesthesia may be used. Without the opportunity to use this modality, patients find it impossible to be treated in the best and most appropriate manner.

In addition, to address a comment made before about the availability of insurance in New York, as a result of a proposed change by the State Insurance Commission in rating procedures, within the last 2 weeks the two major carriers of dental professional liability insurance in New York have apprised us that they will withdraw from the marketplace this spring unless a correction is made.

Third, rates and coverage provisions have been changed, but not justified. Apparently, arbitrary decisions have been made masked in a term familiar to insurance carriers and those who deal with them as "judgmental."

As an example, recent negotiations with our major national carrier broke down when discussions disclosed that a significant increase in projected premium levels was based not on statistics, but on something so small as a telephone conversation held with a competing carrier who related what they thought might happen in the marketplace.

In conclusion, what do unjustified unilateral actions mean? Inability for the public to receive the most modern care, for if the insurance industry governs with no professional expertise or statistical justification, the manner in which dentistry is provided to the public, research and advancement in medical science, will be halted.

We feel we need facts. We need facts to reduce the litigious explosion and we must return optimum care to the patients we serve. We are seeking help in assuring that the insurance industry continues to function honestly, openly and, without tampering with the free enterprise system, unselfishly.

I thank you, sir.

[Prepared statement follows:]

STATEMENT
OF THE
AMERICAN DENTAL ASSOCIATION
ON THE
McCARRAN-FERGUSON ACT
BEFORE THE
COMMITTEE ON JUDICIARY
UNITED STATES SENATE

February 18, 1987

Mr. Chairman, I am Dr. Leslie W. Seldin. I practice general dentistry in New York City and am President of the Dental Society of the State of New York and Vice-chairman of the Council on Insurance of the American Dental Association. On behalf of the Association's 145,000 members, I thank you for the opportunity to present our profession's views at these hearings on the repeal of the McCarran-Ferguson Act.

Our interest in this issue has been heightened in recent years by the problems many dentists have been encountering with professional liability insurance. But for decades, many members of the profession have questioned the fairness of such a broad-based exemption from antitrust laws accorded to the insurance industry, when no similar exemption is provided to the enterprises with which that industry interacts, professional practices and professional associations among them.

These hearings come at a time when there are alarming trends in the professional liability insurance industry which are of great concern to dentistry. Appropriate legislative action now -- in concert with other activities -- will assure the public of the continued availability of dental care of a quality that is a world standard. Should we delay, we fear that the trends that I will be citing will become a nationwide problem for dentistry, as is already the case in some other disciplines.

It is not uncommon today for oral surgeons to pay $24,000 in annual premiums. In some cases, however, rates can be far higher. In Dade and Broward Counties, Florida, for example, premiums for oral surgeons have reached the untenable level of $94,000. For some, this has caused such economic hardship that they have stopped practicing their specialty in favor of general dentistry. But even for general dentists, premiums have increased by an average of 600% over the last two years. This does not bode well for the future affordability of dental care in this country.

Escalating premiums, coupled with limited availability of coverage, have produced a crisis environment for my profession. There continues to be a general absence of competition among carriers to write professional liability insurance for dentists, and those companies willing to provide protection often seek out the lowest risk dentists while avoiding those who practice in large metropolitan areas.

Our principal objective in this matter is assuring our members access to professional liability insurance at a fair price -- regardless of mode of practice. Solving the problems confronting us, restoring stability to the liability insurance market, is a complex task. It will require a concerted effort.

An essential ingredient in this multifaceted effort is insurance reform, specifically legislation to mandate disclosure by insurance companies of rate-making and loss experience information as well as insurability criteria.

We recognize that insurers are now required to provide both financial and statistical data to state regulatory agencies. The State Insurance Commissioners require the reporting of information on premiums, losses, reserves, expenses, dividends, investments and taxes, etc. by line of insurance. However, while such information may meet the needs of the commissioners in monitoring the reporting companies' solvency, its rate filings and policy forms, as well as compliance with state regulations, it is insufficient for the needs of purchasers of liability insurance in that:

* regardless of the availability of data, it is presented in a way that is understandable only by actuaries and regulators and is often indecipherable to the purchaser. This makes it difficult to assess whether premiums have been reasonably determined and allocated equitably among policyholders having varying degrees of risk. A better understanding of the rate-making process could be achieved by supplementing this actuarial presentation with graphics, listings of paid and reserved claims that respect the confidentiality of the insured, and

written commentary that explains the factors that are contributing to rising premiums.

* The reports do not address the specific elements of the companies' experience, which are most directly related to the purchasers' efforts to moderate malpractice trends.

* Insurers should be required to report their claims experience in an understandable form. For dentistry, appropriate parameters of information might include:

- the treatment being performed at the time the alleged incident occurred
- the nature of the injury which was alleged
- whether anesthesia was contributory to the injury
- the dentist's special area of dental practice
- the practice's location
- the amount of damages sought by the patient
- the amount of compensation paid to the patient or the

amount of money reserved for these losses, as well as the costs of defense.

If comprehensive loss information was collected and carefully analyzed, it would assist companies in refining their rate-setting and underwriting procedures. Ultimately, such information could help to stabilize pricing and encourage a competitive marketplace. From the perspective of the Association, access to such data is instrumental in developing risk management programs for the practitioner that focus on the real factors contributing to claims. Dentistry is willing and anxious to help itself, but also believes insurance reform may be required to assure disclosure of claim information that is so essential to our commitment to quality care.

In the professional liability insurance industry, there are too many inexplicable events occurring: extraordinary rate increases, withdrawals of companies from the market, dilution of coverage provisions, limitations upon the performance of certain services or outright exclusion of services from coverage without apparent justification.

For example, many carriers refuse to insure dentists using general anesthesia or conscious sedation. Others exclude coverage when the dentist performs certain surgical and endodontic procedures that are perceived by the insurance company as experimental or unusually risky. These underwriting judgments often appear subjective and made without consulting the profession about the treatment and its associated risks. If this trend towards restrictive underwriting continues, the treatments available to the public will be defined by insurance companies and not by the health care professions. Moreover, if innovative and experimental procedures become uninsurable, the art and science of dentistry in this nation will stagnate as will the well-being of the public which we serve.

The industry is not only restricting the practice of dentistry, but is diluting the scope of coverage through policy exclusions. The Association is of the opinion that when such coverage reductions are made, the company should be obligated to explain the implications to the insured as it may relate to his situation as a dentist. Care must be taken that the financial well-being of the policyholder is not unwittingly compromised through an indiscriminate change in coverage. It would also be desireable for some economic value to be attached to these restrictions and subsequently factored into the rate-making process or permit the insured to buy the exclusion back.

Mandated full discloure of the informaion we described is needed now. If repeal of the McCarran-Ferguson Act advances insurance disclosure, the Assocition supports repeal.

In addition, we recognize the Association's role. Through its state dental societies, the Association has long offered a peer review process to resolve questions about the quality and appropriateness of care. We believe that peer review has been an effective means of resolving many disputes without resorting to the courts. But today, the viability of the peer review process is being threatened by the liability crisis... with liability insurance for those serving on peer review committees, as well as the sponsoring dental society, becoming increasingly difficult to secure or prohibitively priced. The Association is concerned that if the peer review process must be discontinued because of the inability to secure liability insurance, the result will be an increase in the number of disputes which must be resolved through a far more costly trial process.

But peer review is not the only method by which the Association attempts to reduce the incidence of professional liability litigation. Several initiatives are now underway to develop continuing education programs for dentists on loss prevention. These include a series of seminars which instruct dentists on common causes of professional liability incidents and offer recommendations on methods by which the practitioner can reduce his exposures. In particular, the Association is stressing the importance of sophisticated record-keeping, as we have found that this is critical to a successful defense against unfounded malpractice allegations. We are also using mass communication techniques, such as videotapes to reach those dentists who are unable to travel to seminars. For example, a series of videocassettes and accompanying manuals is being developed that focuses on common causes of malpractice incidents. These include such matters as the diagnosis of periodontal disease, complications associated with anesthesia, extraction or treatment of the wrong tooth, swallowed objects, doctor-patient relationships, informed consent, and parasthesia.

The Association is also investigating the feasibility of endorsing a commercially-underwritten professional liability plan -- as it did from 1970 to 1986 -- if this would facilitate a more accurate and cost-effective means of bringing coverage to the marketplace. We are also taking appropriate measures to self-insure the profession's liability exposures should coverage from commercial sources become unavailable or prohibitively priced.

In short, we are exploring all alternatives for moderating future increases in the cost of liability insurance for dentists as well as to assure its availability under all market conditions. But our efforts will only be successful if they are coupled with other, equally critical actions.

Most importantly, the public must be educated about the nature of dental care and the treatment of dental disease so that it will have realistic expectations about treatment outcomes. An unsatisfactory result may be completely unrelated to the quality of treatment. Numbness, for example, can occur in some instances regardless of the dentist's efforts. ADA members understand that they are essential to public education efforts of this kind -- but so are state and federal agencies and the insurance industry.

There must be reforms to the judicial system at the state and federal levels. Among the proposals deserving of attention are:

* Establishing a statute of limitations to reduce the time period in which a malpractice action can be brought.

* Establishing arbitration or medical panels to review claims before trial.

* Requiring plaintiffs or their attorneys to submit a certificate of merit with their malpractice complaint showing that the suit has been reviewed by a health care provider and found to have merit.

* Stipulating that the offer of a settlement by the provider would not be construed as an admission of liability at a subsequent trial.

* Limiting awards for pain and suffering and other non-economic losses.

* Establishing a schedule of awards for medical injuries similar to Workmen's Compensation.

* Permitting period payments of expenses in cases where long-term disability is anticipated.

* Permitting the introduction of evidence on payments the plaintiff has received from his own insurance and other sources and reducing the plaintiff's award of damages by such amounts.

* Requiring plaintiffs who bring frivolous suits to pay the defendant's legal fees and other defense costs.

* Establishing compensation funds administered by the state.

* Requiring that state licensing boards be informed of judgements and settlements in malpractice cases involving their licensees.

* Establishing qualification requirements for expert witnesses.

* Limiting attorney compensation in liability cases.

Other legislative remedies include:

* Requiring practitioners to maintain specified levels of liability insurance, and

* Establishing precise informed consent requirements.

I would like to reemphasize the urgent need for this program of reforms. We request that our testimony be made a part of the official record of these hearings, along with a series of exhibits we have prepared that illustrate the various aspects of this problem we have discussed.

Thank you.

Senator METZENBAUM. Thank you very much, Dr. Seldin.

The hour is growing late. I have spoken with Senator Thurmond, the ranking minority member. We both agreed to waive our questions. If we have any, we will submit them to you in writing. As the author of the legislation, I want you to know I do appreciate your supporting testimony, with some of the reservations that some of you have indicated, which the Chairman himself as indicated, as pertains to the matter of State regulation.

Thank you very much. We look forward to working with you.

Senator THURMOND. I want to thank you for your appearance.

Senator METZENBAUM. Mr. Mark Horning, American Insurance Association; Mr. Robert Seiler, vice president, general counsel and secretary of Allstate, American Council of Life Insurance and Health Insurance Association of America; Mr. Brad Mitchell, chief executive officer and president of Harleysville Insurance, National Association of Independent Insurers; and F. J. O'Neill, Independent Insurance Agents of America.

Gentlemen, let me preface my remarks by apologizing to you for the lateness of the hour, but when your colleagues on the committee want to ask questions and you have already asked yours, you are in no position to cut them off, so please forgive us.

Mr. Horning.

STATEMENT OF A PANEL CONSISTING OF ROBERT S. SEILER, SENIOR VICE PRESIDENT, GENERAL COUNSEL, AND SECRETARY, ALLSTATE LIFE INSURANCE COMPANY, ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE AND THE HEALTH INSURANCE ASSOCIATION OF AMERICA; MARK F. HORNING, AMERICAN INSURANCE ASSOCIATION, ACCOMPANIED BY GEORGE BERNSTEIN; F.J. O'NEILL, INDEPENDENT INSURANCE AGENTS OF AMERICA; AND BRADFORD W. MITCHELL, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, HARLEYSVILLE INSURANCE COMPANIES, AND MEMBER, BOARD OF GOVERNORS, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

Mr. BERNSTEIN. Excuse me, Mr. Chairman. My name is George Bernstein, representing the American Insurance Association. We expected Mr. Horning to be here and I was going to take about one-and-a-half to two of his minutes. I do not see him here at this point. If you want me to——

Senator METZENBAUM. Do you want to go ahead on his behalf?

Mr. BERNSTEIN. I would be glad to go ahead and thank you, Mr. Chairman.

Senator METZENBAUM. You know our rules time-wise.

Mr. BERNSTEIN. Here is Mr. Horning now, so——

Senator METZENBAUM. Well, why do we not, while he is getting set up, hear from Mr. Robert Seiler?

Mr. SEILER. Thank you, Mr. Chairman and members of the committee. We are pleased to share our views with respect to S. 80 and the future of McCarran-Ferguson Act because of its great importance to the industry and its policyholders.

The short time permitted for oral testimony requires that we be frank and to the point. We must vigorously oppose efforts to repeal or modify the McCarran Act. A standard cost-benefit analysis demonstrates that there is no merit in S. 80, no matter how well-intentioned the proponents, just as there was no merit in the past efforts at repeal.

How does S. 80 benefit the consumer? Well, stripped of the rhetoric, two arguments are generally advanced in favor of repeal of McCarran. It is offered as a solution to the commercial liability insurance crisis and, secondly, as offering the benefits of Federal regulation, and read that as FTC regulation of insurance, the only major industry not now regulated by the Federal Government.

Neither argument, in our opinion, has merit. The solution to the commercial liability crisis is alleged to require repeal of the limited antitrust provisos of McCarran, thereby creating more competition.

Implicit in that argument is an unfounded assumption that there is a lack of competition today. By all standard and objective measures, the industry business is one of the most highly competitive and deconcentrated of all industries.

ACLI and HIAA do not represent commercial liability insurers. However, we are consumers of that product. As such, we know from hindsight, and let me emphasize hindsight, that a root cause of today's crisis lies in earlier overly aggressive competition induced by high interest rates and in other external factors all beyond the control of State regulators and industry alike.

We fail to see how additional antitrust litigation or FTC regulation would have prevented the low rates of the 1970s or today's availability problems. How can more competition solve a problem caused by overly aggressive competition? That is the question we must ask.

If there is a Federal solution to the liability insurance crisis, it lies in some other direction, not in repealing McCarran. Nor is there merit or accuracy in the argument that insurance is the only major industry not directly regulated by the FTC.

There is, however, a full measure of Federal elitism and bureaucratic expansionism in that argument. How would Federal regulation have prevented the liability insurance crisis? Are we to believe that Federal regulation would be inherently superior to existing State regulation? Current newspaper accounts relating to the banking and securities industries would indicate the contrary.

In our opinion, S. 80 fails to demonstrate logic, objectivity or a solution to the perceived problem through the proffered remedy. So we really see no benefit to the consumer.

How about the cost to the public and the industry, and there is a cost? While life and health insurance do not make rates in concert, we are concerned about the repeal of the antitrust provisos of McCarran.

Proponents of repeal argue that our limited antitrust immunities are not necessary. They give shortshrift to legal arguments to the contrary. It is that very difference in opinion that concerns us, for it is the battleground on which lawsuits are fought.

Repeal of McCarran will create a whole new job opportunity program for the plaintiff's bar, as it charges off seeking newer, bigger and better treble damage and class action lawsuits. Neither our industry nor the consumer need the uncertainty or the expense produced by the creation of this costly new regulator, the courts and the plaintiff's bar.

Repeal of McCarran would subject all of our trade practices to regulation by the FTC. Our advertising, sales practices, cost disclosure, underwriting, and rating classifications and practices, policyholder services, claims, complaints, record-keeping and other practices, limited only by the ingenuity of FTC staff, all would come under FTC scrutiny. These areas are now pervasively and effectively regulated by the State insurance departments.

The benefit of additional Federal regulation is elusive, at best. The problems, however, are not hard to identify. Repeal of McCarran does not preempt State regulation. It creates a dual, duplicative, and potentially inconsistent system of regulation, which can only mean higher taxes and insurance costs to the public.

Proponents of repeal do not seem to contemplate a giant Federal agency regulating insurance, but that is exactly what will ultimately happen, for in our experience Federal regulation is not easily contained.

I would point out there were 31 studies being undertaken by the FTC at the time the Commerce Committee required that the FTC go back and restrict their activities to areas where they had jurisdiction.

Where is the evidence of a failure of State regulation that could possibly justify such a harsh and expensive solution? And there is even more at stake. Insurance is the sum of local transactions reflecting differing economic, social and political conditions. A Federal regulator cannot and will not be able to appreciate or handle those differences. It will seek uniformity, thereby losing the benefits of pluralistic regulation and the ability to experiment both in regulation and in product competition.

We must also ask how will Federal regulation affect the thousands of small and local regional insurers. Will they be able to cope with pervasive Federal regulation or will this be one more condition driving them to mergers, thereby structurally decreasing competition?

Finally, you must recognize that the life and health insurance industry is a dynamic and changing business because it reflects the changing needs and desires of the consumer for financial security.

We do not know what our future problems will be or what actions will be required to solve them. We do know, however, that McCarran and the historic State regulation of our business gives us a flexible and responsive regulatory structure within which to address those problems.

We see repeal of McCarran as conferring no real benefit upon either the public or the industry, but rather creating great costs for both. So we must oppose S. 80 and other efforts at repeal or modification of McCarran.

We look forward, however, to providing whatever additional assistance we can to the committee as it continues its deliberations, and thank you for your attention to our views, sir.

[Prepared statement follows:]

STATEMENT

OF

ROBERT S. SEILER

on behalf of

THE AMERICAN COUNCIL OF LIFE INSURANCE

and

THE HEALTH INSURANCE ASSOCIATION OF AMERICA

before the

COMMITTEE ON THE JUDICIARY

of the

UNITED STATES SENATE

February 18, 1987

McCarran Statement

Mr. Chairman and Members of the Committee, my name is Robert Seiler and I am Senior Vice President, General Counsel and Secretary of Allstate Life Insurance Company. I appreciate the opportunity to appear before you today on behalf of the American Council of Life Insurance (ACLI) and the Health Insurance Association of America (HIAA) to discuss S.80 and the future of the McCarran-Ferguson Act.

The McCarran-Ferguson Act is the federal statutory foundation for state regulation of insurance, a form of regulation which has existed for over 100 years. Therefore, any suggestion that it should be repealed or substantially modified is of great concern to all the diverse segments of the insurance business should be of great concern to consumers. In my memory there is not another issue which has so galvanized the attention of our business or produced such unanimity of opinion among its members. For reasons detailed in this statement, we must vigorously oppose efforts to repeal or modify McCarran.

The current debate over McCarran is not new. There have been previous bills; previous studies; even some of the proponents of repeal are the same. Current efforts even share the same frailties as existed in the previous debates (i.e. a lack of logic and objectivity; a failure to solve the perceived problems through the proffered solution; the creation of costly new "Regulator's", the courts and the plaintiffs bar; and additional increased taxes and insurance costs to the consumer to support the creation of a dual (state and federal) duplicative and potentially inconsistent regulation of the insurance business. A standard cost/benefit analysis quickly reveals the lack of merit in the proposal to repeal or modify McCarran. A great deal of the debate over McCarran can be reduced to basic differences in regulatory philosophy between the insurance industry and critics of the McCarran Act. Those critics believe that federal regulation is the answer to every question, that federal regulation is inherently superior to state regulation, that only federal regulation is responsive to consumer needs. Put another way, there is a considerable amount of federal elitism inherent in proposals to repeal McCarran, as exemplified by the argument that "After all, insurance is the only major industry not subject to federal regulation." We believe that such views are suspect not only as a general proposition but are clearly erroneous with respect to insurance in particular.

Federal regulation of banking hasn't stopped bank failures, nor has federal securities regulation put an end to insider trading scandals. The real test of regulation is how it responds to problems that arise.

There is no question that on balance the state regulatory system for insurance has been a success. No regulatory system is perfect, but insurance regulation at the state level under

McCarran has been and continues to be an effective and responsive process which compares very favorably with any federal regulatory system. There is no evidence of a need to supplant state regulation of insurance with federal regulation. Nor is there any evidence to warrant an overlaying of state regulation with federal regulation.

McCarran and the Liability Crisis

There may be a number of reasons that this Committee has decided to examine the McCarran-Ferguson Act, including periodic review of the antitrust statutes and immunities. But there can be little doubt that the principal reason for the renewed interest in McCarran-Ferguson relates to the capacity shortage in commercial liability insurance commonly known as the liability crisis. Certainly there are no developments in the life and health insurance business which warrant attention into McCarran. Yet life and health insurance is inextricably tied to, and will suffer from efforts to repeal or modify McCarran.

The ACLI and HIAA do not represent commercial liability insurers, and we are not here to speak for them, but hindsight makes it clear that the liability crisis was and, to a lesser extent, still is the result of complex causes including excessive competition in the commercial liability lines induced by high interest rates in the late seventies, combined with changes in the application of tort law, increasing jury awards, plummeting interest rates in the mid-eighties and a retreat by foreign reinsurers who had provided much of the capacity in the commercial liability area.

Last year, critics of the insurance industry alleged the existence of boycott and price-fixing conspiracies as the cause of the crisis and called for immediate antitrust investigations to be followed by repeal of the limited insurance antitrust immunity contained in McCarran. The Federal Trade Commission (FTC) and the Department of Justice (DOJ) examined the allegations and determined that they were unfounded.

Subsequently some industry critics shifted their focus. If there was no evidence that the crisis was facilitated by the antitrust immunity, then it must simply be the state insurance regulatory structure at fault. Under federal regulation, they argue, such a thing surely would not have been allowed to happen. As a compromise position, of course, they would graciously accept removal of the antitrust proviso.

I appreciate that the objective of Senator Metzenbaum in introducing S.80 is not to dismantle the state regulatory structure and replace it with a giant federal bureaucracy. If I understand his purpose correctly, it would entail FTC regulation of insurance trade practices and general antitrust enforcement authority over insurance. But would the FTC have prevented liability insurers from competing with one another by lowering their prices in the late seventies when interest rates and the investment income for insurers was at an all-time high? What would the consumer and small business groups who are testifying later in these hearings have said about that? Incidentally, I certainly don't recall that those groups were up on Capitol Hill in 1978 and 1979 suggesting that insurance prices were too low. Would we now find an FTC with general jurisdiction over insurance requiring insurers to provide liability coverage for less than its anticipated cost? I suspect that the answer to that question is "no" as well. Certainly, FTC jurisdiction would not have affected interest rates, the tort system, the level of jury awards, or the exodus of foreign reinsurers, all factors which were beyond the control of the regulators and insurers alike. While the Senator's purpose may not be to create a giant federal regulatory structure, we are convinced that that is what will happen.

The small business representatives who are here today are angry about the liability issue and we sympathize with them. But contrary to what these groups may have been told by Mr. Nader or Mr. Hunter, neither the removal of the limited antitrust immunity or federal regulation of insurance would have made a single additional dollar of liability coverage available. Moreover, as we shall see, such action might adversely affect pricing and availability in other lines of insurance.

The really important point here is that the liability crisis and the debate over state versus federal regulation of insurance and the repeal of the limited antitrust immunity are not fundamentally related issues. This distinction is all the more important considering that the commercial liability insurance lines comprise only 2 1/2% of the insurance business. Yet the proposed solutions adversely affect 100% of the business of insurance.

I might point out that insurers have in the past not found it economically feasible to offer some types of flood coverage or riot and crime insurance. That did not result in efforts to repeal the McCarran Act. Instead, the federal government undertook a reinsurance program in those areas and the problem was solved. I am not suggesting the same approach in this case, but it illustrates that it is possible to find solutions to insurance problems without disrupting the insurance regulatory process.

Limited Antitrust Immunity

One of the most common misconceptions about the antitrust proviso contained in the McCarran-Ferguson Act is that it provides insurers with a blanket immunity from the antitrust laws.

Such a characterization is at odds with the plain wording of the statute. The antitrust proviso states that the Sherman Clayton, and FTC Acts will apply to the business of insurance to the extent that such business is not regulated by State law. This is an important distinction to make because it means that to the extent the states do not regulate anticompetitive and unfair trade practices among insurers the federal laws apply. There is therefore no regulatory void associated with the insurance exemption in which anticompetitive practices would run rampant. Further, the Federal statutes are fully applicable to instances of boycott, coercion or intimidation. Most significant, perhaps, is that over the last forty years the courts have ever more narrowly construed the terms "business of insurance" and "regulated by State law" and given broader meaning to the boycott exception. Currently only core insurance activities involving the actual spreading of risk or the relationship between the policyholder and the insurer and which are demonstrably regulated by the states are immune.

We have carefully considered the operation of the McCarran Act as it affects life and health insurance, etc., and have concluded that it should not be repealed or modified for three basic reasons:

A. The life and health insurance business is already highly competitive. There is no evidence that repeal of the exemption would produce additional competitive benefits.

B. Repeal of the limited immunity would cause uncertainty as to the legality of all joint activities of insurers and leave determinations to the vagaries of the judicial process. This is particularly true with respect to those activities which are fundamental to the operation of the operation of the insurance mechanism and which afford increased availability.

C. Repeal would result in unnecessary and duplicate regulation at the hands of the FTC because it would subject the insurance industry to the jurisdiction of the Federal Trade Commission, which would have broad power to regulate our business practices. Such practices are already subject to pervasive regulation at the state level.

A. Competition

One of the principal reasons given by the proponents of repeal or modification of the antitrust proviso is that competition would somehow be enhanced. Curiously, however, there is no suggestion that significant competitive problems now exist, or any indication given as to how the assumed competitive benefit would be manifested.

By every standard objective measure, the life and health insurance industries are highly and increasingly competitive. (For a more detailed competitive analysis of life insurance, see Appendix A). Since 1950 the number of life companies has grown from 611 to 2260, a gain of nearly 300%, indicating that barriers to entry are not high. Since 1957 the market share of the eight largest firms as measured by assets has declined from almost 60% to 43%, indicating steadily decreasing concentration. Most significantly, however, the market share of new business for the top 8 firms has declined over the same period from 58% to 19% suggesting that smaller firms have been able to compete quite effectively with larger ones. The market share for the top 10 health insurers dropped from 49% in 1965 to 32% in 1985, the largest company's market share dropped from 9% to 6% over the same period. Few other industries can exhibit such deconcentration trends. One of the principal reasons that there is relative ease of entry into life insurance is the wide availability of a large pool of shared mortality and morbidity data which create ease of market entry forecloses the possibility of an absolute cost advantage for established insurers.

Another helpful indicator of competitiveness, profitability, shows life and health insurers in the low to moderate range having a five-year average return on equity of 13.1% and trailing utilities at 14.3%, banks at 14.9%, thrift institutions at 15.8% and brokerage houses at 19.4%.

Availability of coverage, discussed previously in the context of commercial liability insurance, is not a problem with respect to life and health insurance. Life insurance ownership is widely distributed among all economic groups. Overall it is estimated that over 154 million Americans are covered by some sort of life insurance policy, and over 188 million are covered by some form of private health insurance.

One of the most dramatic indicia of competitiveness in life insurance is that the price of basic insurance protection has declined an average of 36% since 1955. These price decreases are due to a number of factors including increases in investment earnings, improvements in mortality, technological advances, relatively stable commission rates and most significantly, the pressure of competitive forces which have necessitated price reductions to consumers where the expense reductions and increases in efficiency have allowed.

As tested by traditional economic benchmarks, the life and health insurance markets are competitively structured and have operated in a highly and increasingly competitive manner. Further application of the federal antitrust laws is not likely to improve either the market structure or market performance of the industry. Rather, such action could have negative implications for the present competitive atmosphere.

B. Repeal would create uncertainty - discourage beneficial activities

Because life and health insurers do not use a joint rate making process requiring an antitrust immunity, we are often asked why the antitrust proviso is important to us. The simple answer is that we do not view the antitrust proviso as some sort of a price-fixing license. It does, however, perform two basic functions which life and health insurers believe are very important:

(1) The proviso gives meaning to Congressional intent expressed in McCarran that the States have primary responsibility to regulate the business of insurance.

(2) The proviso lends certainty and stability to the insurance marketplace.

(1) The proviso gives meaning to Congressional intent expressed in McCarran that the States have primary responsibility to regulate the business of insurance. It gives state regulators the ability to carry out their responsibilities and pursue their regulatory objectives without the prospect of having turf disputes with staff at the Department of Justice or FTC who may know a great deal about antitrust ideology but very little about the requirements and complexities of the insurance mechanism. Remember that all states prohibit unfair methods of competition in insurance and vest enforcement powers in the insurance commissioner. In the enforcement of these laws, the commissioner under McCarran need not worry that he will run afoul of whatever antitrust enforcement policy is then in vogue in Washington. Absent the proviso, this type of flexibility would be lost.

(2) The proviso lends certainty and stability to the insurance marketplace. In the forty-two years since McCarran was enacted, it has been thoroughly dissected by the courts in scores of cases. Obviously, new cases still arise from time to time. The overall result, however, is that insurers and regulators now have a very clear understanding of the antitrust proviso's boundaries. To repeal the antitrust proviso, would create uncertainty over every joint activity of insurers and place us once again at the beginning of a long and arduous trail of costly litigation.

Certainly there would be concerns over DOJ and FTC activism. Our real worry, however, is the likelihood of defending a flood of misguided lawsuits brought by the private plaintiffs' bar which must even now be warming to the prospect of foraging through the files of an industry which is perceived as having had antitrust "immunity" for the last forty years. This is not an irrational fear on our part. The notion that the existence of even a limited immunity necessarily breeds anticompetitive conduct was recently vocalized by no less than the FTC Chairman himself speaking before an insurance gathering in Florida. "The very fact that the business of insurance has been shielded from view is reason enough to suspect that it needs to be examined in the light of day." We should point out that insurance has not been shielded from view of the state insurance regulators, and only in limited fashion from the FTC.

Life and health insurers engage in a number of joint activities which could be subject to challenge if the antitrust proviso were repealed. Each of these activities has as its fundamental underlying purpose the broadening of coverage availability, reasonable and affordable premium rates and the promotion of industry efficiency.

Participation in guaranty associations - When a life or health insurance company becomes insolvent, responsibility for its obligations may be assumed by the guaranty association, as a unit, or by one or two other insurers. This could include continuation of coverages, establishment of rates, servicing of policyholders and payment of claims. It is possible that these actions, or others taken by state guaranty associations could precipitate antitrust litigation. However, in order to best protect the interests of the insurance consuming public and those of the policyholders and beneficiaries of policies issued by insolvent or impaired insurers, it is imperative that state guaranty associations retain the flexibility to perform their responsibilities in the manner most economic and efficient for each particular situation.

Reinsurance and Reinsurance pools - Many life and health insurers act as reinsurers or participate in reinsurance agreements. Functionally, reinsurance is simply the process of spreading the potential loss associated with large risks among a number of insurance carriers so that no individual carrier's solvency is threatened. Reinsurance thus increases the capacity to accept new risks and higher limits and enables smaller insurers to compete effectively with larger insurers.

As indicated above, repeal of the proviso could invite litigation and cause reinsurers and reinsurance pools to cease performing some or all of the roles described above or it would sorely inhibit them in their performance of these roles.

Other joint activities such as the sharing of loss and expense data would appear to be permissible under the antitrust statutes, but again could be subject to extensive litigation at the hands of the private bar.

In sum, participation by life and health insurers in state guaranty associations, reinsurance agreements, and pools and cost and health care data exchanges constitutes collective behavior of great importance to the life and health insurance industries and to the insurance consumer public. Repeal of the antitrust proviso would raise uncertainties that could inhibit insurers from engaging in these activities. This would have an extremely negative effect in all lines of insurance on availability, price, industry efficiency and ultimately, consumers.

Laundry list exemption proposal - It has been suggested that loss of the antitrust proviso could be compensated for by providing specific exemptions for "essential collective activities." This approach would handicap the industry's ability to respond on its own in addressing the needs of a changing environment. While a revised statute might identify current essential activities, it could not foresee what activities might be essential in the future. If the proviso were repealed, legislative action would become necessary to allow for any new activities. A timely response by industry for the public good would become impossible.

For instance, over the last several years, health insurers have instituted a variety of mechanisms aimed at controlling the rising costs of medical services. Some of these have involved activities such as seeking implementation of hospital budget approval laws, professional standards review, and provider education. A narrowing of the proviso which did not specifically contemplate this activity, or future activities not yet developed, could inhibit insurer initiatives to help to find answers to the national problem of rising health care costs. Such a result would not be in the public interest.

Disruption of the body of insurance law based on state regulation also increases the potential for unnecessary and costly litigation as noted previously. Any new statute would be subject to a vast array of varying interpretations by antitrust enforcement agencies, the courts and the private bar.

State action defense - It has been suggested that, notwithstanding the application of the antitrust laws to the business of insurance, the so-called "state action" doctrine would be sufficient to allow the states to continue their role as the industry's primary regulators and permit some types of co-operative conduct by insurers which might otherwise be questionable under the antitrust laws.

Current judicial interpretation of the "state-action" immunity requires (1) a clearly articulated state policy to grant antitrust immunity to an activity and (2) active state supervision of the activity. Would each of the 50 states go through the laborious process of re-defining all the insurance activities for which they intended an insurance antitrust immunity to apply? Could it be done in timely fashion? Would the level of state supervision of an activity satisfy judicial interpretations of the "activity supervised" test? Would these interpretations vary from state to state and activity to activity?

Clearly, a reliance on the state-action doctrine would do very little to alleviate the uncertainty surrounding repeal of the antitrust proviso. Moreover, since the system already in place clearly permits the collective activities described above and since there is no indication of any significant competitive problem in the industry, why repeal the immunity? Proponents of repeal are hard-pressed to demonstrate any concrete consumer benefit to outweigh the vast disruption and uncertainty which would result.

C. FTC Trade Practice Jurisdiction

We are often asked why the FTC should be prevented from exercising the same type of regulatory authority over insurance that it may exercise over virtually every other industry. The fact is, of course, that the FTC does not have general regulatory authority over a number of significant industries including banking, savings & loans, securities, communications, common carriers and public utilities. All of these industries are shielded from full FTC scrutiny because they share a common characteristic, they are all subject to extensive regulation at the hands of other state or federal agencies. This is no less true of insurance which is pervasively regulated at the state level.

Those who favor removing the insurance antitrust exemption have concentrated almost exclusively on the dubious notion that competition or availability would be enhanced thereby. Nowhere has the assertion been made that insurance trade regulation at the state level is inadequate or needs to be replaced by or overlaid with FTC regulation, and yet that is what would happen were the FTC Act to be generally applied to the business of insurance.

The involvement of the FTC in insurance regulation is unnecessary. In the three year moratorium period following the enactment of McCarran, the states were given the opportunity to enact legislation regulating insurance trade practices to an equal or greater degree than was possible under the language of the FTC Act and in so doing, preempt the FTC for trade regulation purposes. Virtually all the states responded by passing Unfair Trade Practice Acts for insurance in which the operative language was identical or parallel to that contained in Section 5 of the FTC Act. Since that time, using such language as a foundation, the states have developed further specific regulations to deal with difficult insurance issues as they have arisen. In 1972, these Unfair Trade Practice Acts were substantially strengthened and now provide protection for consumers much beyond that which would be possible under FTC Act language alone. 1/

Because different state insurance departments may initially take different approaches to solving the same problem, there is the opportunity (which would not exist under all-your-eggs-in-one-basket federal regulation) to see in a relatively short period of time the results of a broad range of regulatory experiments. Typically, those which prove the most successful become universally adopted.

In a similar way, the experiences of different state insurance departments are drawn on by the National Association of Insurance Commissioners (NAIC) in the development of the various Model Insurance Acts. In the life and health insurance field these Model Acts, which generally have received wide acceptance, cover such topics as nonforfeiture, valuation, holding companies, cost disclosure, mergers, policy language simplification, blindness, sex discrimination, claim settlement practices, policy loan interest rates, group insurance and replacements. (Appendix B contains further detail on state initiated laws and regulations on life and health insurance).

In order to help facilitate the enforcement of unfair trade practice and other model statutes, the NAIC has developed a market conduct surveillance guide which details the procedures to be followed in conducting an extensive examination of insurance practices in four key areas: 1) advertising and sales; 2) underwriting; 3) rating; and 4) claims. This guide has been adopted by many state insurance departments to aid in their periodic insurance examinations.

In short, state regulation is flexible, responsive and comprehensive. Those who favor the FTC's involvement in insurance trade regulation, will assert that state regulation has fallen short in some areas. As discussed earlier, no regulatory system is without faults, and there is always room for improvement. The key question is whether the states act to correct problems as they become apparent.

1/ For example, in addition to prohibitions against unfair methods of competition and unfair or deceptive acts and practices (FTC Act Section 5 language), these unfair trade practices acts contain specific prohibitions against such things as misrepresentations of benefits, conditions, terms, advantages, dividends shares, surplus, and financial condition; misrepresentations for the purpose of inducing lapse, forfeiture, exchange, conversion or surrender; false advertising, defamation, boycott, coercion, intimidation, unfair discrimination, etc.,2/ For example, in addition to prohibitions against unfair

The Baldwin-United Plan - A prime example of the flexibility and adaptability of the state insurance regulatory system and the positive effect of the antitrust proviso is the response to the collapse of the Baldwin-United organization.

Baldwin-United grew during the seventies from a piano company into a complex business conglomerate with interests in banks, savings and loans, mortgage banks, real estate, property and casualty insurance, and life insurance and annuities, as well as numerous non-financial concerns, totalling some 500 separate business entities. The collapse of this far-flung empire left Baldwin's two principal insurance subsidiaries, one in Arkansas and one in Indiana, with liabilities exceeding assets by approximately $1 billion.

The Insurance Commissioners of Arkansas and Indiana quickly acted to place the insolvent companies in rehabilitation proceedings under the supervision of the courts. The process of examining these insolvencies and evaluating possible courses of action was closely coordinated by the two insurance departments and the National Association of Insurance Commissioners. The major industry trade association (ACLI) was asked by the NAIC to develop a plan to protect policyholders in cooperation with the brokers who sold a major share of the business. Ultimately, it was concluded that the most effective and least costly means of protecting the interests of Baldwin-United's policy and annuity holders was through a voluntary participation plan (overseen by the NAIC and approved by the courts) involving leading insurance and securities firms. This cooperative effort, which has come to be known as the Baldwin-United Enhancement Plan, has made it possible for policyholders of Baldwin-United's insurance subsidiaries who so opt to recoup all of the money they had recoup all of the money they had invested, plus interest, or to continue their insurance and annuity contracts. By proceeding in this fashion, rather than through a protracted liquidation and guaranty fund assessment process, costs will be greatly reduced and policyholders will receive benefits in the form of interest that would not be available even to depositors of failed banking institutions under the FDIC program.

While the McCarran antitrust immunity is arguably not essential to the enhancement plan, its absence would create a risk of antitrust litigation which would make insurers very reluctant to enter into voluntary arrangements of this type. In addition, it is unlikely that a federal insurance regulatory system would have proved flexible enough to permit the enhancement plan (with its cost and consumer benefits) to have been implemented.

An analysis of the development of state laws in the insurance area and state responses to arising problems is the best argument against those who wish to supplant state regulation with an untried federal substitute. Were FTC jurisdiction to be added to the existing regulatory framework it is likely that considerable conflict and duplicate regulation would result.

Conclusion

The liability crisis was and is a product of complex causes. However, neither the regulatory system for insurance nor the industry's limited antitrust immunity bear any demonstrable relationship to the liability problem. While the liability insurance is a part of the insurance business, it is a small part, and problems arising there should not suggest that the regulatory framework for the entire industry be abandoned or overlaid with an additional federal regulatory structure for antitrust and trade regulation.

Moreover, the benefits of general application of the antitrust statutes to the business of insurance are highly speculative and in any event outweighed by the confusion and uncertainty which would attend the loss of four decades of judicial precedent as to the legality of joint insurer activities. Further, the application of FTC trade regulation jurisdiction to insurance would address no apparent problem and would result in unnecessary, duplicate and conflicting regulation, all of which would be likely to increase taxes and the cost of insurance, create availability and affordability problems in other areas of insurance and slow down industry and regulatory responses to emerging problems.

If there are specific problems in the insurance which Congress believes need to be addressed, this can be done with specifically targeted legislation rather than the throwing-out-the-baby-with-the-bath water approach of S.80.

Finally, no consideration of a repeal or modification of McCarran is complete without asking question: In light of the insurance industry's strong feelings about the need for McCarran, what will it do if McCarran is repealed? I can't answer that question with certainty. I can identify a few of the alternatives; first it can, in an effort to obtain certainty and reduce duplicative costs of regulation, seek a federal regulator and the preemption state regulation; or second, seek to bring as much of the activities and existing state regulation within the perimeters of the "state action" doctrine. In either case, neither the consumer nor the industry could expect concrete benefits to offset the potential problems of tampering with a system that is by all objective criteria working well. I again thank the Committee for providing the opportunity for us to express our views.

APPENDIX A

Competitive Analysis of Life Insurance Market

A. Market Structure

1. Number and size distribution of life insurance companies.

In January 1950, there were 611 life insurance companies in operation in the United States. As of December 1985, there were a record 2,260 companies in operation, nearly four times the 1950 figure (see Exhibit 1). The growth in the number of operating firms is the outcome of dynamic changes reflected in the entry of new firms attracted into the industry and the exit of others. Exhibit 1 shows that while the number of firms leaving the industry has grown during the 1980s, an even larger number of firms have entered, enlarging the pool of competitors within the industry.

The presence of a large number of firms does not in itself assure a competitive market structure in the industry. If a small number of firms control most of the market, the presence of many firms may only give the illusion of competition. Exhibit 2 shows various measures of concentration in both the 4 and 8 largest life companies since 1957. Regardless of the concentration measure cited, the 8 largest companies have experienced a rather substantial decrease in market share since 1957. Industry assets held by the 8 declined by 16 percentage points between 1957 and 1985, while premium income earned and insurance in force fell by 28 and 25 percentage points, respectively, over the same period.

More revealing, however, is the column indicating the share of new life insurance sold by the 8 largest firms. In 1957, the big 8 accounted for 58 percent of new business written. By 1985, however, they accounted for a mere 19 percent of the new business, a decline of 39 percentage points. This suggests that smaller life companies have been able to compete quite effectively with the larger ones.

In manufacturing industries, the measure of shipments is analogous to new business in the life insurance industry. Exhibit 3 shows shipments as concentration ratios for a number of different manufacturing industries. In none of the industries shown did the concentration of sales display a decline as dramatic as that in life insurance. Indeed, concentration actually increased in most of the cited industries.

2. Barriers to entry.

In this section, we take a look at the condition of entry into the life insurance industry. The level of competitive pressure within an industry is partly linked to whether there is ease of entry or not. New entrants or the threat of potential entrants serve to exert such pressure on established firms. In determining the condition of entry into an industry, analysis is usually focused on the presence or absence of economic barriers.

Economic barriers typically fall into one of the three following categories: absolute cost advantage, economies of scale, and product differentiation. Absolute cost advantage occurs when a small group of firms has control over a production process or inputs that are vital to the operation of the business, such that it becomes difficult for new firms to enter.

In the life insurance business access to a pool of mortality statistics is the closest thing to a vital input for new companies, since it helps those with no loss experience of their own to estimate what the costs on a particular contract are likely to be. With these estimates, new companies can set prices accordingly. The wide availability of mortality statistics (which could be ended by the loss of the insurance exemption--see below) forecloses the possibility of an absolute cost advantage for established insurers.

Economies of scale refer to the significant fall in the average cost of production as the size of the firm and the level of output increase. In industries which necessitate large plant and equipment and high volume of production in order to achieve low cost operation, the number of prospective entrants is small, being limited to those who can undertake substantial investments. Even then, the potential entrant, which has to produce at high volume, must consider the effect of his entry on the market price. If the expected price that takes into account the new supply, is not sufficient to ensure profitable production, entry will not occur.

The available evidence suggests that such economies are greatly limited in the life insurance business and that, therefore, relatively small firms can and do survive profitably alongside the giants.*/ Additional evidence that there are no substantial disadvantages to being relatively small is provided by Exhibit 4 which cites several "small" firms that have been in operation for some time. There are many others. Indeed, the bulk of all life companies fall into the small category. Exhibit 5 shows that there were 1,219 life insurance companies with less than $10 million assets, representing 55 percent of the total number of companies in 1984. It will also be noted that there were relatively more life insurance companies in each of the four size categories under $10 million than commercial banks and thrift institutions.

Product differentiation refers to the ability of established firms to create brand loyalty, such that new firms have difficulty in getting their product accepted in the market. In such a situation, the new entrant will need substantial funds for promotions if it must try to capture sales. Thus, entry will be limited to those firms which can secure the requisite financing to advertise and promote their products. The growth in the number of life companies as shown in Exhibit 1 and the relative decrease in large company market share shown in Exhibit 2 suggest that product differentiation has not been an effective barrier.

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*/ Randall Geehan, "Returns to Scale in the Life Insurance Industry," Bell Journal of Economics, Autumn 1977.

B. Market Performance

Our analysis of market performance will look at four basic areas: profitability, pricing, availability and product innovation.

1. Profitability. If an industry's profits are consistently higher than normal (normal profits being defined as that just sufficient to attract and retain capital) then there is an implication that the industry is not workably competitive. In the case of the life insurance industry, ease of entry and the low levels of concentration would lead one to expect that industry is not abnormally profitable. Data in Exhibit 6 confirm this expectation by showing that rates of return in life insurance are comparable to those of other industries. Obviously, making inter-industry comparisons of profitability is a hazardous task at best, but the data shown are consistent with the notion that competitive forces are working within the life insurance industry to hold profits to a moderate level.

2. Availability. By the end of 1985, 81 percent of all U.S. households owned life insurance. As Exhibit 6 suggests, the ownership of life insurance is widely distributed. As might be expected, ownership incidence was higher among husband-wife households. Similarly, ownership incidence is higher at high levels of household income. Nevertheless, better than half of all households with incomes under $15,000 were covered by some form of life insurance policy. Overall, it is estimated that some 154 million Americans are covered by some sort of life insurance policy. This set of data strongly suggests that life insurance is widely demanded and available.

3. Pricing. Pricing behavior is a primary indicator of the level of competition within an industry. Generally, the higher the competition, the lower the price. As Exhibit 8 shows, the net payment per $1,000 of whole life insurance has decreased steadily since 1955, by an average of 36 percent. Few other industries can make the same claim about their products.

These decreases in price are due to a number of factors such as the increases in interest earned on investments, improvements in mortality, technological advances, relatively stable commission rates and most significantly, the pressure of competitive forces, which has necessitated price reductions to consumers where the expense reductions and increases in efficiency have allowed.

4. Product Innovation -- It is generally agreed that product innovation is directly related to the degree of competition within an industry. We see many examples of the introduction of new products by life insurance companies in the years since the passage of the McCarran Act.

In the 1950s, for example, family policies were developed to provide whole life protection for parents and term protection for their spouses and for any number of children, all under one policy. Around 1960, in response to the concern of many young people that they might become uninsurable by the time they would be able to afford adequate insurance coverage, the guaranteed insurability policy rider was developed. This rider enables an individual to purchase additional coverage every two to five years without having to furnish evidence of insurability. Then, in the '60s and early'70s, variable annuities and variable life insurance were developed to meet the needs of consumers preferring more growth potential rather than the policy guarantees usually associated with insurance products.

At no time has the pace of product development been as rapid as in the period starting in the late '70s. The life insurance marketplace has been completely transformed in this very brief time, and today many insurers are writing most of their business on plans that were not conceived ten years ago. One of the principal reasons for these changes was consumer demand for interest sensitive features in their life insurance products. The competition for this portion of the market has been fierce and has resulted in the creation of many new interest sensitive products. Universal life insurance is the most widely known of these recent product innovations. This type of product now accounts for about 40 percent of new individual life insurance volume. It affords the insured broad flexibility in the amount and timing of premium payments and in the level and extent of coverage. Indeterminate-premium policies, also introduced at about the same time, enable an insurer to reflect anticipated favorable experience by charging a premium lower than the maximum premium guaranteed by the policy. A variety of new variable life insurance plans have also been developed, offering in some cases the type of premium flexibility provided under universal life insurance and the opportunity for the insured to choose among a number of different investment options.

As tested by all of the traditional benchmarks, the life insurance business has always been highly competitive and is clearly becoming more so. It is therefore extremely unlikely that the application of the federal antitrust laws to the business of insurance would measurably improve the level of competition or benefit consumers.

Exhibit 1

ENTRIES AND EXITS IN THE LIFE INSURANCE INDUSTRY

Year	Number January 1	Entries	Exits	Number December 31	Change
1950	611	44	6	649	+ 38
1960	1,425	96	80	1,441	+ 16
1965	1,547	149	67	1,629	+ 82
1970	1,773	73	66	1,780	+ 7
1975	1,757	63	74	1,746	- 11
1976	1,746	85	89	1,742	- 4
1977	1,742	89	42	1,789	+ 47
1978	1,789	117	66	1,840	+ 51
1979	1,840	116	61	1,895	+ 55
1980	1,795	155	92	1,958	+ 63
1981	1,958	137	104	1,991	+ 33
1982	1,991	152	83	2,060	+ 69
1983	2,060	137	80	2,117	+ 57
1984	2,117	166	90	2,193	+ 76
1985	2,193	NA	NA	2,260	+ 67

NA = Not Available.

Source: American Council of Life Insurance

Exhibit 2

Concentration Ratios in Life Insurance

YEAR	Percent of Assets Held By		Percent of Premium Income Earned By		Percent of Insurance In Force Sold By		Percent of New Business Written By	
	Top 4	Top 8	Top 4	Top 8	Top 4	Top 8	Top 4	Top 8
1957	44.2	59.1	40.4	55.0	41.1	55.6	41.2	57.5
1962	42.6	57.2	36.9	51.1	37.6	51.3	33.0	46.9
1969	40.7	54.6	33.5	47.6	37.7	46.0	30.4	44.7
1972	38.8	52.5	29.4	43.0	30.0	42.7	25.3	37.3
1977	36.0	49.6	27.9	41.5	29.0	40.9	24.6	33.8
1982	32.5	45.7	20.6	30.0	24.1	34.8	17.6	25.5
1985	30.7	43.2	19.1	27.5	21.6	30.3	12.8	18.6

Source: American Council of Life Insurance

Exhibit 3

Concentration Ratios in Selected Manufacturing Industries

YEAR	Fluid Milk		Soft Drinks		Boys Suits		Greeting Cards		Cement		Motors and Generators		Primary Aluminum	
	Top 4	Top 8	Top 4	Top 8	Top 4	Top 8	Top 4	Top 8	Top 4	Top 8	Top 4	Top 8	Top 4	Top 8
1958	23%	29%	11%	15%	18%	28%	43%	59%	32%	50%	48%	57%	82%	90%
1963	22	29	11	16	19	30	53	67	29	49	47	56	93	n.a.
1967	21	29	13	19	26	40	62	73	28	48	44	56	91	100
1972	17	26	14	20	42	58	64	74	26	47	45	57	80	94
1977	17	26	14	21	41	58	70	78	24	41	39	53	76	93
1982	15	26	15	24	63	78	80	84	32	53	36	52	67	91

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n.a. - not available.

Source: Department of Commerce

Exhibit 4

Examples of Small Life Insurance Companies
Formed Before 1950

	Assets	
	1955	1985
Atlantic Coast Life (1925)	6,059,044	33,377,005
Consolidated General Life (1946)	949,673	7,054,765
Mutual Savings Life (1927)	10,562,304	207,205,091
Golden State Mutual (1925)	11,366,622	111,826,362
National Farm Life (1946)	2,239,626	56,285,033
Texas Life Insurance (1901)	17,404,130	149,974,976
United Home Life Insurance Co. (1948)	5,389,079	45,444,120

Source: American Council of Life Insurance.

Exhibit 5

Selected Financial Institutions - Number, By Type of Institutuion and Asset Size: 1984

	Life Insurance Companies	Insured Commercial Banks	Savings and loan Associations	Mutual Savings Banks	Credit Unions
Total	2,211	14,481	3,391	267	15,144
Less than $250,000	231	2	70	-	2,902
$250,000 - $999,000	288	9	70	-	4,444
$1.0 million $4.9 million	498	320	130	-	4,688
$5.0 million - $9.9 million	202	1,150	135	1	1,284
$10.0 million - $24.9 million	240	4,064	422	7	1,051
$25.0 million - $49.9 million	163	3,761	600	3	403
$50.0 million - $99.9 million	168	2,741	671	57	226
$100.0 million - $499.9 million	262	1,956	1,034	136	139
$500.00 million or more	159	478	329	63	7
Total	100.0	100.0	100.0	100.0	100.0
Less than $250,000	10.4	(Z)	2.1	-	19.2
$250,000 - $999,000	13.0	.1	2.1	-	29.3
$1.0 million - $4.9 million	22.5	2.2	3.8	-	31.0
$5.0 million - $9.9 million	9.1	7.9	4.0	.4	8.5
$10.0 million - $24.9 million	10.9	28.1	12.4	2.6	6.9
$25.0 million - $49.9 million	7.4	26.0	17.7	1.1	2.7
$50.0 million - $99.9 million	7.6	18.9	19.8	21.4	1.5
$100 million - $499.9 million	11.8	13.5	30.5	50.9	.9
$500.0 million or more	7.2	3.3	9.7	23.6	(Z)

- Represents zero. Z Less than $50 million or .05 percent.

1/ Source: U.S. Federal Deposit insurance Corporation, Statistics on Banking, annual.

2/ Source: U.S. League of Savings Institutions, Washington, D.C., The Savings and Loan Source Book, annual.

3/ Excludes federally chartered mutual savings banks.

4/ Source: National Credit Union Administration, National Credit Union Administration Yearend Statistics 1984. Excludes nonfederally insured State chartered credit unions and federally insured corporate credit unions.

Source: Compiled from sources listed in footnotes by the U.S. Department of Commerce Bureau of the Census. Statistical Abstract of the U.S., p. 492 (1985). Life company data are from the American Council of Life Insurance.

Exhibit 6

Profitability of Selected Industry Groups
1982-1986

Industry Groups	Return on equity (5-year average)
Soft drinks	22.6%
Life and health insurance	13.1
Brokerage houses	19.4
Banks	14.9
Thrift institutions	15.8
Cement and gypsum	5.8
Apparel	11.7
Chemicals	11.8
Electric utilities	14.3

Source: "Whos's Where in the Industry Groups," *Forbes*, pp. 258-260 (January 12, 1987).

Exhibit 7

PERCENT OF HOUSEHOLDS IN WHICH AT LEAST ONE MEMBER IS COVERED BY SOME FORM OF LIFE INSURANCE, 1984

All Households	81%
Husband-wife households	88
With children	87
Age of Household Head	
Under 25	66%
25-34	79
35-44	87
45-54	89
55-64	91
65 and older	71
Household Income	
Under $15,000	69%
$15,000-19,999	80
20,000-29,999	91
30,000-49,999	92
50,000 or more	92

Source: Life Insurance Marketing and Research Association

Exhibit 8

TRENDS IN AVERAGE NET PAYMENTS AND 20-YEAR SURRENDER COSTS FOR $10,000 WHOLE LIFE POLICY FOR A 25- AND A 45-YEAR OLD MALE: COST PER $1,000, AVERAGE OF 30 PARTICIPATING AND 30 NONPARTICIPATING POLICIES ISSUED BY 60 U.S. LEGAL RESERVE LIFE INSURANCE COMPANIES

Year	Net Payment per $1,000 Face Amount		Surrender Cost per $1,000 Face Amount	
	Age 25	Age 45	Age 25	Age 45
1955	$15.28	$30.15	$ 7.30	$17.25
1960	14.40	28.58	6.49	15.67
1965	13.48	27.21	5.84	14.36
1970	13.19	26.65	5.46	13.68
1975	12.93	26.09	5.26	13.15
1980	11.85	24.15	4.87	11.77
1985	9.77	19.37	3.83	7.93

Source: American Council of Life Insurance

Exhibit 9

Variable, Universal and Flexible Premium Variable Life Insurance in Force (000 omitted)

	Variable Life Insurance		Universal Life Insurance		Flexible Premium Variable Life Insurance	
Year	Policies	Amount	Policies	Amount	Policies	Amount
IN U.S. COMPANIES						
1976	2	$ 46,541	—	—	—	—
1977	6	168,632	—	—	—	—
1978	8	224,497	—	—	—	—
1979	12	382,716	N.A.	N.A.	—	—
1980	27	965,576	N.A.	N.A.	—	—
1981	92	3,720,739	61	$ 4,868,293	—	—
1982	192	7,636,076	500	40,439,550	—	—
IN THE UNITED STATES						
1983	341	13,885,000	1,642	131,309,000	—	—
1984	507	21,506,000	4,007	319,922,000	*	**
1985	615	29,055,000	6,836	563,609,000	106	$6,052,000

N.A.—Not available.

Note: Excludes reinsurance assumed.

*Fewer than 500.

**Less than $500,000.

Source: American Council of Life Insurance.

APPENDIX B

STATE INSURANCE REGULATION - LIFE INSURANCE

CONSUMER PROTECTION

Regulation of the life and health insurance business is all-pervasive and literally encompasses all activities engaged in by insurers from the time a solicitation is made until the contract terminates, whether by payment of the death benefit or otherwise.

State insurance regulators draw their primary consumer protection authority from Unfair Insurance Trade Practice Acts which have been enacted in every state. As a rule, these statutes are modeled after Section 5 of the FTC Act and prohibit "unfair or deceptive acts or practices" in insurance.

State insurance regulators have used this broad authority to develop and implement extensive specific consumer protection regulations on insurance. The National Association of Insurance Commissioners (NAIC), the trade organization for state insurance regulators, has aided this process by developing various model laws which the states may adopt to deal with specific insurance concerns.

Among the Model laws which have been developed are the Model Annuity and Deposit Fund Disclosure Regulation, Model Regulation on Unfair Discrimination on Basis of Physical or Mental Impairment, Model Regulation on Unfair Discrimination on the Basis of Blindness or Partial Blindness, Model Regulation on Unfair Discrimination on the Basis of Sex in Availability of Life & Health Insurance, Life Insurance Disclosure (Solicitation) Model Regulation, Model Universal Life Insurance Regulation, NAIC Unfair Claims Settlement Practices Regulation, Group Health Insurance Replacement Regulation, Group Model Coordination of Benefits Regulation, and the Replacement of Life Insurance and Annuities Model Regulation. These model regulations illustrate the evolutionary nature of life and health insurance products and marketing, as new regulations are constantly being prepared and older ones updated to keep pace with industry changes. The Model Life Insurance Disclosure Regulation, for example, is undergoing extensive review currently to see if new methods of disclosing relative costs of products is needed in light of the new interest sensitive products.

Other laws and regulations are more fundamental in scope, such as those regulating credit life and credit health insurance. Those acts, and implementing regulations, deal not only with the required disclosure to consumers but also the relationship between the insurer, insured and beneficiary, in specifying premium rate guidelines, policy provisions and underwriting criteria including Model Individual Policy Provisions Law, Model Group Life and Health Insurance Law, Model Minimum Standards for Health Insurance

Policies Law, Group Health Insurance Continuation, and Conversion Law. The Model Insurance Information and Privacy Protection Model Act is a comprehensive structure of limitations on the use of confidential information as well as mandated disclosures to consumers about the information gathering function of insurers.

Most persons are aware that insurance agents are licensed by the state, but few outside the industry are aware that many states require a course of education prior to licensing and continuing courses of study afterward. A Model Regulation was adopted by the NAIC in 1976 setting forth continuing education requirements for agents.

The contracts and policies issued by all life and health insurance companies must be filed with, and approved by, state insurance departments. The terms and conditions of such contracts, including the type size and "readability", are strictly regulated by the various statutes and regulations in each state. (NAIC Life & Health Insurance Policy Simplification Model Act.) State laws regarding life insurance contracts typically state that the policy may contain no exclusions other than for preexisting conditions or suicide (up to two years), and for such things as aviation or war. Furthermore, the policies must be incontestable after two years. Other provisions strictly regulate the rights of policyholders in the event the policy lapses or is surrendered, i.e., the nonforfeiture provisions. Like the reserves required by law, the nonforfeiture benefit is based on statutorily prescribed tables of mortality and interest rates. Mortality tables are approved by the NAIC as are the methods for determining interest rates to be used in calculating minimum reserves and nonforfeiture values. In addition health insurers are subject to NAIC Model Rate Filing Guidelines and stringent reserve requirements. The Standard Valuation and Nonforfeiture Laws developed and approved by the NAIC have been adopted in all jurisdictions, the latest version being that approved by the NAIC in 1980.

SOLVENCY

The preceding discussion has focused only on the consumer protection measures as they relate to the marketing of life and health insurance, the underwriting and the terms of coverage. The other very significant function of regulation is in the continued financial solidity of the industry, and the scope of regulatory measures in this arena is even more pervasive. Furthermore, much of the activity in this area is perhaps less formalized in model laws and model regulations since it is dependent to a significant degree on the vigilance and judgment of the insurance regulator. For example, as noted earlier the Standard Reserve prescribe the basis for life insurance reserves. In addition, the investment codes of each state set forth the limitations on investment of assets to assure a mixture of diversity and security. Furthermore, many investment codes include qualitative standards, and the NAIC through its Securities Valuation Office monitors and determines market quality of various securities not otherwise valued in the open market. None of these, however, is capable of measuring the liquidity needs of a particular insurance company based on the specific insurer's products, growth, surrenders, etc. While most insurers do such measurements as part of ongoing management, it is a constant concern of the regulators since poor judgment, or other bad management practices, can readily lead to serious cash flow problems and resulting financial difficulty. The NAIC is actively working on proposals for guidelines in this very important area.

The NAIC has established the Insurance Regulatory Information System (IRIS), a data base of information on substantially all insurance companies from which certain tests are run for each company to determine whether problems may be occurring. Depending on the results of these tests, companies will be classified on the basis of their financial health and could be placed on either a "watch" or "targeted" list, depending on the potential seriousness of the problem. A company on the "targeted" list would be subjected to special examination; a "watch" listed company may be required to file more frequent financial reports or take other corrective steps.

Of course, the information required to be filed in the various states by insurers is comprehensive, and the Annual Statement prescribed by the NAIC is constantly under review to assure currency of needed data. The financial examination system assured on the premises confirmation of the data, practices and procedures of each insurance company. Recent concern with reinsurance agreements has prompted numerous regulatory measures and requirements in the last few years. Currently regulatory study of this subject has led to pending proposals dealing with letters of credit used in reinsurance and other issues.

Two other major areas of regulation are essential to this discussion. The NAIC Model Insurance Holding Company Act, revised extensively in 1985 following the Baldwin United situation, provides numerous requirements for insurers and owners of insurance companies to avoid transfers of assets or other inter-affiliate dealings harmful to the solvency of insurance companies. The other major system of laws are the state insurance guaranty associations. Based on model legislation first adopted by the NAIC in 1970 and recently substantially revised, these laws provide a mechanism for assuring coverage for policyholders of insolvent companies.

Senator **Metzenbaum**. Thank you.

Mr. Horning.

Mr. **Horning**. Thank you, Senator Metzenbaum.

Senator **Metzenbaum**. You know we have a 5-minute rule?

Mr. **Horning**. Yes, sir.

I am accompanied today by George Bernstein, who, like I, is representing the American Insurance Association. Mr. Bernstein is a former Federal insurance administrator and he will also——

Senator **Metzenbaum**. We cannot hear you.

Mr. **Horning**. My remarks today will focus on the legal issues that arise from S. 80, and I have furnished the committee with a written statement, so I will try to confine my remarks to what I perceive to be some of the main issues.

I think the starting point in the debate on repealing the McCarran Act is the recognition that the Federal antitrust laws and State insurance regulation have sometimes conflicting objectives.

The Federal antitrust laws operate under the assumption that competition is the only means for making a product more available and lowering its price. In contrast, State insurance laws recognize that in some cases cooperation, such as in rate-making and underwriting, is a superior means of making coverage more widely available at an affordable price, while not endangering the public through insurance company insolvencies.

Therefore, I think the fundamental question surrounding S. 80 is whether the McCarran Act has proven to be an effective means of reconciling these two approaches. AIA thinks it has done a good job for several reasons.

First of all, the McCarran Act does not ignore the role of the antitrust laws in the insurance area. The Act provides only a limited antitrust exemption, not a broad one. In fact, back in 1945 Congress rejected a bill that would have given the industry a complete exemption. It adopted a different approach, an approach that was suggested by State insurance regulators; that is, an exemption would be provided only for forms of cooperation that were proven to be publicly beneficial and which were regulated by the States.

This approach has been implemented through imposing three requirements in the McCarran Act before an insurance company can obtain an antitrust exemption. First of all, the activity in question must qualify as "the business of insurance."

This term has been very narrowly defined by the courts. In fact, there have been two major Supreme Court decisions in the past decade. I was involved in both. The Justice Department urged the Court to give a narrow reading to the Act and on both occasions the Court did.

In fact, Chief Justice Rehnquist in one of those cases cast the deciding vote in favor of a narrow view of the exemption.

A second requirement, of course, is that the activity be regulated under the State insurance code. Therefore, insurance companies are simply not free to engage in collusion or illegitimate forms of cooperation.

Third, there is no exemption whatsoever for the grossest form of anti-competitive conduct, boycotts, exclusionary behavior. That type of behavior is not exempt whether or not the States regulate.

In contrast, if the McCarran Act were repealed, I think this balance would be lost. In the area of most concern to the insurance industry, which is rate-making, the antitrust laws are very inflexible. They do not permit any agreements or exchange of information among competitors that look to future pricing.

The per se rule of illegality does not permit you to justify it on grounds that it contributes to the ability of the insurance industry to price their product accurately, to make rates commensurate with what they expect to be future losses.

In fact, the FTC and the Justice Department in studies conducted over the past 10 years agree with this view. They say that all the insurance industry could do absent the McCarran Act would be to collect data on old claims. They could not project that data into the future, which is essential if insurers are to be able to rate their risks accurately.

The impact would be the most severe on small companies. In fact, that was a major concern of Congress back in 1945. They are precisely the companies that need access to the industry-wide data base. They are precisely the companies that would be most hurt by repealing the antitrust exemption.

Repeal of the Act, therefore, would not lead to more competition in the industry. It might, in fact, drive out small companies and lead to less competition.

A second major problem with repeal of the McCarran Act has to do with the threats of treble damage lawsuits that Mr. Seiler alluded to. Right now, there is not any law on some of the major areas of cooperation in the insurance industry. Joint underwriting for large risks, for risky classes of policyholders—there is no precedent there.

How would the antitrust laws treat these arrangements? Would they treat it as a lawful joint venture or would they treat it as a market dividing up customers, an illegal agreement to divide up the market? We simply do not know that.

In the face of that uncertainty, I am afraid many insurers would decline to join in joint underwriting arrangements, even where encouraged to do so by State regulators.

I will stop my remarks right there so I give Mr. Bernstein an opportunity to comment.

[Prepared statement follows:]

PREPARED STATEMENT

OF

MARK F. HORNING

on behalf of

THE AMERICAN INSURANCE ASSOCIATION

Mr. Chairman and Members of the Committee: I appreciate the opportunity to appear today to present the views of the American Insurance Association on S.80, a bill to repeal the McCarran-Ferguson Act. AIA opposes this legislation, because it would diminish, not enhance, the ability of the insurance industry to make property and liability insurance widely available to the public at an affordable price.

My remarks today will focus on the legal issues presented by S.80. My perspective is that of an attorney who has represented insurance industry organizations and companies in antitrust litigation and counseling. I have been extensively involved in litigation on the McCarran Act, including the four most recent Supreme Court decisions construing the Act.

Those advocating repeal of the McCarran Act rely heavily on three legal conclusions concerning the scope of the McCarran Act and the applicability of the antitrust laws to the insurance business if the McCarran Act were repealed. I do not believe that any of these conclusions stand up when they are measured against the decisions of the courts and the legislative history of the McCarran Act:

First, the antitrust exemption in the McCarran Act is characterized as too broad. Allegedly, the McCarran Act permits insurance companies to engage in a wide variety of anticompetitive practices free from any regulatory constraint. In actuality, however, the exemption is a very narrow one. This has been made clear by three Supreme Court decisions in the last decade that have limited the McCarran Act's antitrust exemption significantly.

Under those rulings, the Act provides an antitrust exemption only for a small number of cooperative activities. Principally, these are the pooling and analysis of statistical data necessary for ratemaking purposes; the joint underwriting of risks that no single insurer prudently could assume; and the development of standardized insurance policy forms that make a complicated product more understandable to consumers. The McCarran Act's antitrust immunity is available, moreover, only where state governments regulate these activities. Finally, there is no antitrust immunity for insurance companies that engage in any "boycott, coercion, or intimidation."

Second, proponents of repeal conclude that, absent the McCarran Act, insurance companies could still engage in these legitimate forms of cooperation because the courts recently have taken a more liberal view of the antitrust laws. While this is no doubt true in some areas of the law, it is not a correct reading of the law in the area of most concern to the insurance industry -- ratemaking. The courts have not deviated from the view that competitors cannot share, or act together in developing, information on future prices or costs. Any such cooperation is illegal no matter what the justification. Thus, unlike the McCarran Act, existing antitrust law makes no allowance for the insurance industry's unique need to cooperate in the prediction of future losses, so that rates can be set commensurate with expected claims.

Third, proponents of S.80 conclude that repeal of the McCarran Act would not impair the states' ability to regulate insurance, and would not place insurers in the dilemma of complying with conflicting federal antitrust laws and state insurance laws. In fact, however, the federal antitrust laws would be supreme except in the case of state regulation meeting the rigorous standards for the so-called "state action" exemption. That exemption applies only where a state adopts the most restrictive, anticompetitive form of regulation. In all other states, if the McCarran Act were repealed, insurers would have to obey the dictates of the antitrust laws regardless of state regulatory laws or policies.

As a result, in those states, insurers would be deterred from engaging in publicly beneficial forms of cooperation, even if approved by state regulators, whenever there was uncertainty about the antitrust status of their cooperation. Repeal of the McCarran Act, moreover, might lead state regulators to conclude that they could preserve their regulatory jurisdiction only by enacting anticompetitive forms of regulation that unambiguously displace the federal antitrust laws. Thus, ironically, one possible effect of repealing the McCarran Act would be to create incentives for regulation leading to less competitive markets, not more competitive ones.

Each of these issues is discussed in more detail below.

The McCarran Act Is A Narrow Antitrust Exemption

The McCarran Act does not cover insurance companies with a blanket antitrust exemption. To the contrary, insurance company practices are exempt only if each of three separate requirements are met: (1) the practices in question must constitute the "buisness of insurance"; (2) those practices must be "regulated by State law"; and (3) the practices must not constitute an "agreement to boycott, coerce, or intimidate or act of boycott, coercion, or intimidation." 15 U.S.C. §§ 1012(b), 1013(b). The courts have not made it easy for insurance companies to meet these standards, because, in the Supreme Court's words, "[i]t is well settled that exemptions from the antitrust laws are to be narrowly construed." Group Life & Health Insurance Co. v. Royal Drug Co., 440 U.S. 205, 231 (1979).

1. The "Business Of Insurance" Requirement: Congress passed the McCarran Act, not to provide a broad antitrust exemption for the insurance industry, but to provide a more limited one. Prior to the Supreme Court's decision in United States v. South-Eastern Underwriters Association, 322 U.S. 533 (1944), insurance companies were not subject to the federal antitrust laws at all, because insurance was not deemed part of interstate commerce. When South-Eastern Underwriters

made the insurance business fully subject to the federal antitrust laws, there were initial proposals before Congress to exempt the insurance industry totally. The House of Representatives actually passed a bill which would have provided such a blanket exemption.

Congress, however, ultimately rejected this approach in favor of a much more restricted antitrust exemption. The idea -- which Congress adopted from a bill proposed by state insurance regulators -- was to provide an antitrust exemption only for certain essential or useful forms of cooperation between insurance companies. Congress' principal concern was to prevent the antitrust laws from disrupting intra-industry cooperation in statistical analysis and ratemaking that, especially for smaller companies, was crucial in order to underwrite risks accurately. Group Life & Health Insurance Co. v. Royal Drug Co., 440 U.S. 205, 221-22 (1979).

The "business of insurance" term, therefore, was meant to be a narrow one by Congress and has been so interpreted by the courts. Indeed, in its last two decisions, the Supreme Court has read the "business of insurance" term very restrictively. In doing so, the Court has adopted positions urged by the Justice Department. There is now a stringent, three-part test to determine whether a particular practice is part of the "business of insurance." Specifically, the practice must involve the transfer or spreading of risk from a policyholder to an insurer; the practice must be an integral part of the relationship between the insurer and the policyholder; and the practice must be unique to the insurance industry. Union Labor Life Insurance Co. v. Pireno, 458 U.S. 119, 129 (1982). Under this standard, the lower courts have ruled that a wide variety of practices are not eligible for antitrust immunity.

2. The State Regulation Requirement: Even if a practice qualifies as the "business of insurance", the McCarran Act antitrust exemption does not apply unless the practice is regulated under a state's insurance code. As a result,

insurance companies are not free to engage in collusion or illegitimate joint activities. Rather, they can engage in joint action only where the states authorize or regulate such cooperation. Nor are insurance companies free to engage in deceptive advertising or other unfair sales practices. Such practices are prohibited by unfair trade practices legislation or equivalent statutes in every jurisdiction. Moreover, the McCarran Act does not provide an exemption from state antitrust laws. Consequently, state attorneys general and insurance commissioners have full authority to investigate any allegation of anticompetitive conduct.

3. The "Boycott" Exception: In passing the McCarran Act, Congress was careful not to exempt joint activities that had no legitimate justification, such as improper exclusionary conduct. The McCarran Act precludes any antitrust immunity whatsoever for "boycotts, coercion, and intimidation" -- even if the states regulate or prohibit such conduct. In the Barry case, the Supreme Court ruled that this boycott exception encompasses not just boycotts of competitors, but any insurance company agreements to refuse coverage to particular customers or withdraw from particular states or territories. St. Paul Fire & Marine Insurance Co. v. Barry, 438 U.S. 531 (1978). As a result, both the Antitrust Division of the Justice Department and the Federal Trade Commission have full authority to investigate alleged boycotts -- and, in fact, have done so on several occasions in recent years.

In sum, the McCarran Act's antitrust exemption is confined to regulated, non-exclusionary practices that are essential to the insurance industry's ability to provide affordable and available coverage.

The Antitrust Laws Would Not Permit Insurance Companies To Cooperate In Ratemaking

The statement accompanying introduction of S.80 contends that, after repeal of the McCarran Act, recent changes in the antitrust laws would still permit insurance companies to engage in essential collective activities. Insofar as the statement suggests that the antitrust laws would permit cooperation in setting rates or projecting future losses, the court decisions simply do not support such a reading. Indeed, there is a large body of decisions that leaves no doubt about the state of the law. This law is not newly-established; it was in existence when the McCarran Act was passed and was a major reason why Congress decided that an antitrust exemption was needed.

These cases prohibit competitors from exchanging information for the purpose of setting future prices. The courts' approach is to view *any* exchange of price-related information among competitors as highly suspect. Starting from this premise, the courts regularly have struck down efforts to collect and publish information on prospective prices and costs. For example, trade associations may not publish suggested prices or fees, they may not predict future price levels and they may not estimate future costs. *See*, *e.g.*, *American Column & Lumber Co. v. United States*, 257 U.S. 377 (1921); *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 781-83 (1975); *Plymouth Dealers' Association v. United States*, 279 F.2d 128 (9th Cir. 1960). In addition, the courts have struck down a variety of agreements among competitors even though they affected prices only indirectly. *See*, *e.g.*, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940); *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978). Competitors are prohibited even from exchanging information on the last price they charged in recent transactions. *United States v. Container Corp. of America*, 393 U.S. 333 (1969); *United States v. United States Gypsum Co.*, 438 U.S. 422 (1978). Upon proof of an agreement, any such efforts are regarded by the courts as illegal *per se*, that is, unlawful whether or not consumers or competitors were injured and regardless of the business justification for the practice. The *only* data that competitors safely can exchange are average or aggregate figures on prices and costs in closed transactions. *Maple Flooring Manufacturers Association v. United States*, 268 U.S. 563 (1925).

At most, these decisions permit only the collection and analysis of historical data. But in the insurance business, information on prospective costs is most important. In setting rates, the main costs are future losses which, by definition, are not known at the time that prices must be set. Rather, insurers must estimate these costs, a task that can be done accurately only by extrapolations and projections of current data. This can be done only if insurance companies cooperate in collecting timely information and in projecting or "trending" such data. Pooling of current information is essential because a broad data base must be assembled; cooperation in trending is important because the requisite expertise is not widely available. In particular, smaller companies do not have the capability to perform these tasks themselves and must rely on industrywide organizations.

If the McCarran Act were to be repealed, however, this is precisely the kind of cooperation that existing antitrust standards do not permit. Because of the inflexible rule of per se illegality, the courts would not take account of the unique justification for rate-related cooperation in the insurance industry.

Even proponents of repealing the McCarran Act agree that the antitrust laws would not permit such cooperation. For example, in a study conducted during the Ford Administration, the Antitrust Division concluded that the Sherman Act would prohibit insurers from any statistical cooperation except the mere collecting, without analysis or extrapolation, of historical data on losses. The Pricing and Marketing of Insurance: A Report of the Department of Justice to the Task Group on Antitrust Immunities 169-72 (1977). Later, in the Carter Administration, an antitrust study commission similarly agreed that the antitrust laws would permit only the "calculation of past cost data." Report of the National Commission for the Review of Antitrust Laws and Procedures 238 (1980). Nothing in more recent antitrust decisions provides any basis for altering these conclusions. If anything, the courts have been more inclined to prohibit cooperation among competitors that might affect pricing. See, e.g., Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980); Arizona v. Maricopa County Medical Society, 457 U.S. 332 (1982).

With regard to the other forms of industry cooperation that the McCarran Act was designed to protect, the antitrust laws are by no means so clear as the proponents of S.80 would suggest. Indeed, because the antitrust laws do not now apply to such efforts, the courts have not yet had occasion to provide any guidelines for such insurance industry activities as joint underwriting of large risks. As a result, repeal of the McCarran Act would generate a long period of uncertainty as the courts struggled to apply the antitrust laws in a new context.

One thing can be predicted with relative certainty, however. If the McCarran Act were repealed, insurance companies would soon face large antitrust class actions challenging the legality of industry cooperation and alleging damages in the millions of dollars. A recent example suffices. When the FTC issued a complaint in 1985 challenging title insurance rate bureaus, class actions were filed across the country within weeks. Moreover, despite assurances from incumbent government officials about the legality of industry cooperation, there is no guarantee that, in the future, the Justice Department and FTC, under other leadership, would not challenge joint underwriting or similar cooperation. For example, notwithstanding the McCarran Act, in the 1960s the Antitrust Division brought suit to dissolve pools formed by insurance companies to underwrite aviation accidents.

For insurers, the consequences of McCarran Act repeal thus would be uncertainty in the law, the prospect of costly litigation, and the threat of massive jury verdicts. In these circumstances, many insurers understandably might decline to cooperate with others in jointly underwriting catastrophic risks, hazardous activities, and liability coverage for small businesses and local governments. Repealing the McCarran Act, therefore, would tend to restrict, not increase, the availability of coverage for those classes of policyholders that have the most difficulty in obtaining it.

Insurers Would Face The Dilemma Of Complying With Conflicting Federal And State Laws

The central purpose of the McCarran Act was to preclude the federal antitrust laws and other federal statutes from impairing, invalidating or superseding state laws regulating or taxing the business of insurance. 15 U.S.C. § 1012(b). Nevertheless, the statement accompanying introduction of S.80 argues that repeal of the McCarran Act would have no adverse impact on the states' ability to regulate insurance, because, since 1945, the states supposedly have done away with much of that regulation. Representatives of the National Association of Insurance Commissioners can address this assertion better than I can. However, let me briefly state that the alleged lack of state regulation would come as quite a surprise to the member companies of AIA. While there has been an evolution in state regulatory laws since 1945, the property and casualty insurance market is still a pervasively regulated one.

In the majority of states, insurers must obtain approval of the specific rates they charge; in all but a few of the remaining states, the law prohibits excessive, inadequate or discriminatory rates. Insurers are also subject to a wide spectrum of other laws designed to preserve their solvency, guarantee their reliability and regulate their underwriting. In recent years, as insurance availability problems have developed, state regulators have become more active, not less so.

Repeal of the McCarran Act, therefore, would place insurers in the dilemma of continuing to comply with state regulatory laws while at the same time having to comply with a new and potentially conflicting form of regulation, the federal antitrust statutes. Let me give a concrete example. Many state insurance commissioners have urged insurers to form Market Assistance Programs (MAPs), which are designed to help small businesses and others to find insurance in the private market when they have difficulty finding it on their own. Many state regulators have urged the industry to adopt such plans because they are superior to state-run programs and less intrusive on competition. But, if the McCarran Act were repealed, such plans might very well be challenged as an illegal agreement to allocate customers. Facing this risk of litigation, what insurance company would want to participate in such a plan? State insurance commissioners would find themselves frustrated in carrying out their statutory obligation to ensure that their citizens have adequate access to insurance coverage.

Advocates of repealing the McCarran Act counter this argument by claiming that any such conflict could be resolved through so-called "state action" immunity from the antitrust laws. The statement accompanying S.80 suggests that a recent Supreme Court decision, Southern Motor Carriers Rate Conference v. United States, 471 U.S. 48 (1985), established new principles that make the "state action" doctrine more widely available than it was in 1945. In reality, however, "state action" immunity is available only in limited circumstances and would not accommodate many forms of state insurance regulation.

The Supreme Court first established "state action" immunity in Parker v. Brown, 317 U.S. 341 (1943), two years before passage of the McCarran Act. Before Congress, opponents of the McCarran Act, including the Justice Department, argued that Parker v. Brown made new legislation unnecessary. Congress rejected this argument. Under Parker v. Brown, only the most anticompetitive forms of regulation would have displaced the federal antitrust laws. Therefore, Congress feared that the "state action" doctrine would not permit the states sufficient flexibility in choosing whatever form of regulation best suited their needs.

This concern is equally valid today. In essence, for the "state action" doctrine to apply, the state must decide to totally displace the forces of competition with a regulatory scheme that compels the practices of private businesses or requires them to obtain advance approval each time before they act. In the insurance market, however, many states have forms of regulation which, although they regulate rates extensively, do not totally supress insurers' flexibility in setting rates and do not require the state affirmatively to approve every rate filing regardless of how significant it is. These forms of regulation probably are not sufficient to invoke the "state action" exemption. Consequently, if the McCarran Act were repealed, insurers in those states would be subject to conflicting forms of regulation and state regulators would have diminished authority.

In contrast, the McCarran Act gives states wider latitude. For the McCarran Act exemption to apply, the states must regulate insurance, but they are free to choose whatever form of regulation they believe is most satisfactory. Repeal of the McCarran Act not only would limit this flexibility but have a more perverse effect. In effect, Congress would be telling state regulators that, if they wished to retain full jurisdiction over the insurance industry, they must revise their laws to adopt the most restrictive, anticompetitive form of regulation possible.

The Current Prohibition On FTC Insurance Studies, Except As Authorized By Congress, Should Not Be Repealed

In 1980, Congress added § 6(h) to the Federal Trade Commission Act to prohibit the Commission from issuing reports on the insurance industry except to the extent authorized by the Senate or House Commerce Committees, the committees with FTC oversight jurisdiction. Recently, this measure has been attacked as imposing a new restriction on the Commission, going beyond even the McCarran-Ferguson Act. In actuality -- as the legislative history clearly shows -- that provision was enacted because the FTC was ignoring the McCarran Act.

The McCarran Act does not differentiate between the FTC's various powers under the Federal Trade Commission Act. Rather, so long as the stringent requirements of the McCarran Act exemption are met, the FTC has no authority to investigate insurance, whether by means of a law enforcement investigation or a rulemaking proceeding or a factfinding study.

But in the late 1970s, the FTC abruptly adopted the view -- with no support from the legislative history of the McCarran Act -- that the Act applied only to law enforcement investigations. Instead, the Commission asserted that it was free to study any aspect of the insurance business notwithstanding that it was regulated by the states. Many in Congress felt that these "factfinding" studies were thinly-veiled attempts to substitute the judgment of the FTC for that of state regulators and as a stepping stone towards federal regulation of insurance.

Congress' remedy to this extra-legal assertion of powers was to prohibit the FTC from doing what it never had the authority to do in the first place. Under the 1980 legislation, the FTC may study any aspect of the insurance business so long as it obtains Congressional authorization. Correctly viewed then, the 1980 amendment merely establishes congressional checks and balances on the Commission's observance of the statutory limits on its jurisdiction.

The McCarran Act Is The Best Means of Reconciling The Federal Antitrust Laws And State Insurance Codes

From a public policy standpoint, the fundamental issue raised by S.80 is the best means of reconciling the often conflicting objectives of the federal antitrust laws and state insurance laws. While competition in the insurance marketplace has important benefits, it is not the only objective. An equally important consideration is preserving the solvency and reliability of insurers, which may warrant limits on competition and regulation which is not consistent with the antitrust laws.

Over the past forty years, the McCarran Act has proven to be an effective means of accomodating these twin objectives. The antitrust exemption in the Act is narrow in scope and it has been thoroughly defined by the courts. In 1980, Congress reconsidered the wisdom of the McCarran Act, in deciding whether to restate the limits of the FTC's jurisdiction. The result was that Congress gave the McCarran Act a vote of confidence.

For these reasons, proponents of repealing the McCarran Act bear a heavy burden in demonstrating that anticompetitive problems are so rife in the insurance industry that removal of the antitrust exemption is justified. I believe that most objective observers would conclude that there are no such problems. Indeed, both the Antitrust Division and the FTC have concluded, in the past year, that the insurance industry is one of the least concentrated and most competitive in the country. Both agencies specifically rejected allegations that recent increases in liability insurance rates were attributable to anticompetitive practices. In the words of the Antitrust Division, "[a] more plausible explanation of the current problems in the property and casualty insurance industry is that they are a result, for the most part, of the problems in the tort liability system." See letter from Douglas H. Ginsburg, Assistant Attorney General, to Jay Angoff, April 22, 1986. Given this factual record, I do not think a case has been made out for repeal of the McCarran Act.

Mr. Chairman, that concludes my prepared statement. I would be pleased to address any questions that you or other members of the Committee might have.

Senator **Metzenbaum**. I do not know how much time you have left, Mr. Bernstein. Until the light goes on, we will be glad to hear from you.

Mr. **Bernstein**. Thank you, Mr. Chairman.

The basic premise that I would bring to this discussion——

Senator **Metzenbaum**. The light is on.

Mr. **Bernstein**. If I may have 1 minute?

Senator **Metzenbaum**. Please.

Mr. **Bernstein**. Thank you.

This is not an antitrust issue. S. 80 is a State-versus-Federal-regulation issue. In the introductory remarks of the chairman in putting this bill in, he spoke of the pricing and availability crisis of the last couple of years.

No one, not the Justice Department, not GAO, not the FTC, not any study of the last 10 years which we have heard referred to, not any witness today, has said once how availability of insurance or price of insurance will be helped by repeal of McCarran-Ferguson.

Not one more policy will be written at one dollar less if McCarran-Ferguson is repealed.

The Justice Department and all these agencies, GAO, the National Commission, all recognize that this is a competitive industry. In fact, the task force last year referred to it as an atomized industry. Competition is rampant in this industry.

As was said last year and said again by Senator Hatch this morning before he left, to say that you are going to cure what some people allege is the cause of the availability crisis—namely, too much competition—by repealing McCarran-Ferguson in the name of more competition is patently absurd, and "patently absurd" are words that I quote.

Senator **Metzenbaum**. Thank you.

Mr. **Bernstein**. May I just add one last point, sir?

What repeal is all about of McCarran-Ferguson is the opportunity for the States to be superseded by the Federal government. It is the first step. No one, not anyone in this room or any place else, believes for 1 minute that the Congress of the United States is going to stop by giving total competitive freedom to the insurance industry.

It is going to impose rate regulation; it is going to impose data requirements. The McCarran-Ferguson Act is the buffer to that, and that is the reason why S. 80 and acts like it to modify or repeal McCarran-Ferguson are a direct challenge to State regulation of insurance.

Thank you.

Senator **Metzenbaum**. Mr. O'Neill.

Mr. **O'Neill**. Mr. Chairman, I am Mike O'Neill. I am an independent insurance agent from Wilmington, Delaware. I am speaking today on behalf of the Independent Insurance Agents, and my remarks are also endorsed by the National Association of Casualty Insurance Agents.

First of all, let me say that I am an agent; I sell insurance to make my living. If insurance companies cannot provide a product to sell, as has been the case in certain lines of commercial insurance coverages during the availability-affordability issue, then both the consumer and the agents are losers.

Mr. Chairman, we share a common concern and goal with this committee—providing affordable insurance to the public. As someone who deals with the consumer on a daily basis, let me explain what the repeal of the McCarran-Ferguson Act means for both the consumer and the independent agent.

In order to provide consumers with the information they need and the expertise they demand, I must keep abreast of policy changes, coverage availability, and underwriting guides of more than one company. But my most important responsibility is knowing my customers' needs and which company to turn to for the best coverage at the best price.

In representing over 20 companies, the only way I can perform the minor miracle of knowing which company offers the best coverage is because my companies, and thousands of others subscribe to rating bureaus.

While rating bureaus often perform the function of advising rates, they also classify insurance risks and prepare standard insurance policy forms which are essential for efficiency in agencies and for quality consumer service. These functions would certainly be exposed to attack if subjected to Federal antitrust laws.

Without McCarran-Ferguson, it is not at all certain that the classification plans, rating plans, and the policy and endorsement forms could continue to be developed on a joint basis. Each company would be required to prepare their own manuals, underwriting rules, and policy forms.

It would become extremely difficult for independent agents to compare between the coverages and prices of their companies and pricing of the several companies in tailoring an insurance package for a particular insured. As a result, the increased opportunity for making a mistake would, in all likelihood, increase the administrative expenses for agents in the form of higher errors and omissions liability premiums for protection against the consequence of errors.

When other costs such as education, reduced productivity, and additional personnel are factored in, agents could be forced to represent fewer companies, thereby limiting the choice available to the consumer.

Additionally, modification of McCarran-Ferguson trouble insurance people in general for three reasons. First, the general public and businesses do not seem to understand the effect of the McCarran-Ferguson Act, and specifically the limited antitrust exemption that has been placed on insurance regulation. Second, the Federal government has had some poor past examples of forays into the regulation business; and, third, the existence of an unpredictable nature with the judicial system charged with interpreting congressional intent.

These three reasons add up to a risk we recommend avoiding. Uncertainty and unpredictability are not factors for success, neither are they comforting notions for an industry made up of professional risk-takers.

Agents are specifically concerned about the distinct possibility that the daily operation of agencies would be thrown into a long-term state of disarray if substantial changes were made to the present system of regulation.

Licensing requirements, commission practices, and general operating procedures would all be subject to a new layer of regulation, although these areas are not the cause of any problems existing in the marketplace today. Moreover, the potential legal jeopardy confronting agents would require them to scrutinize new company procedures and policies with an eye to their potential antitrust consequences.

Many agents around the country have another concern. Smaller, local, regional companies would cease to exist if the McCarran-Ferguson Act is repealed. These companies have small actuarial staffs and little loss data on which to base rate-making for property and liability insurance.

If rating bureaus are unable to pool statistical data and these small, local, regional companies are unable to compete with the larger ones, both consumers and agents lose. There will be less, not more, competition. Some of these regional companies provide needed coverage in certain lines hit hard by the availability-affordability crisis.

Mr. Chairman, you will hear from small businesses that they are upset and perplexed by the liability crisis. However, repeal of the McCarran-Ferguson Act could be viewed as punitive rather than constructive change for an industry which admittedly deserves some criticism of its recent practices in the marketplace.

Although not perfect, we strongly support a State-regulated system and enhancement of that system, where necessary. Improved solvency laws and more training and funding for State insurance departments are only two areas we would like to see addressed at the State level.

Repeal of McCarran-Ferguson would likely lead to a dual regulatory system and certainly result in expensive litigation, uncertainty, and confusion for the industry and consumers.

Senator **Metzenbaum**. Can you wind up, Mr. O'Neill?

Mr. **O'Neill**. Just a few seconds.

Consumers will ultimately bear the burden of the impact upon the marketplace. I appreciate your time.

[Response to questions follows:]

Independent Insurance Agents of America
INCORPORATED

WASHINGTON OFFICE
SUITE 200
600 PENNSYLVANIA AVE., S.E.
WASHINGTON, D.C. 20003

202/544-5833

April 6, 1987

The Honorable Joseph R. Biden, Jr.
United States Senate
489 Russell Senate Office Building
Washington, D.C. 20510

Dear Joe:

I am responding to the questions in your letter regarding the McCarran-Ferguson Act. As a witness on behalf of the Independent Insurance Agents of America at your February 18 hearing, I am pleased to provide you with any information you may require.

Your first and second set of questions concern life and health insurance vis-a-vis the McCarran-Ferguson Act. As you may know, the Independent Insurance Agents of America represents predominately property/casualty agents, and therefore I do not feel adequately qualified to address the ramifications that repeal of the McCarran-Ferguson Act would have on the life and health insurance portions of the industry.

There is no division of opinion, however, between the life, health and property/casualty sectors of the industry regarding repeal of the McCarran-Ferguson Act. Attached is a copy of the letter sent to members of the Judiciary Committee signed by the fourteen insurance organizations representing all facets of the industry. The letter emphasizes the unity of the industry in opposition to repeal of the Act.

You inquired whether there is a difference between large and small companies in relation to the McCarran-Ferguson Act. The smaller the company, the more it benefits from the McCarran Act's anti-trust exemption for intra-industry cooperation. Smaller companies tend to have more need of industry cooperation in pooling and analyzing data since smaller companies have little or no internal data bases and less expertise. For this reason, we believe that repeal of the McCarran Act could actually decrease competition and lead to greater concentration in the industry.

Your third set of questions concern modern data processing capabilities and whether new advances eliminate the need for a limited anti-trust exemption. IIAA believes new technology has increased effectiveness of industry data collection and analysis, although there is still a need for cooperation.

Accuracy in ratemaking still depends on insurers agreeing to pool their data into an aggregate data bank. Individual company data, irregardless of technology, simply does not have the statistical significance of aggregate, industry wide data. However, should the McCarran Act be repealed, this form of cooperation would certainly be suspect under anti-trust laws.

Once again, I appreciated the opportunity to testify before your Committee, and I trust you will contact me if you require any additional information.

Sincerely,

Mike

F. J. O'Neill
For The Independent Insurance
Agents of America

FJO:gg

Attachment

Senator **Metzenbaum**. Thank you. Mr. O'Neill, I have to ask you one question. Have you testified often before committees or do you only testify when your client, Senator Biden, is here?

Mr. **O'Neill**. For 7 years I have been a legislative representative as an agent for Pennsylvania, Maryland and Delaware, and have done numerous testimonies.

Senator **Metzenbaum**. I wondered if it was especially because of Joe.

Mr. **O'Neill**. No.

Senator **Metzenbaum**. But Joe did want me to say that he is sorry he could not be here to hear your testimony. He was very interested in doing so. He is tied up at the Foreign Relations Committee.

Mr. **O'Neill**. I appreciate that, Senator.

Senator **Metzenbaum**. Thank you very much.

Mr. Mitchell.

Mr. **Mitchell**. Thank you, Mr. Chairman. I am Bradford W. Mitchell, Chairman and Chief Executive Officer of the Harleysville Insurance Companies in Harleysville, Pennsylvania. I am also a member of the board of governors of the National Association of Independent Insurers, as well as past chairman of the NAII.

I am appearing on behalf of the NAII, my company, Harleysville, as well as the Alliance of American Insurers and the Reinsurance Association of America.

The National Association of Independent Insurers is a non-profit trade organization of 500 property-casualty insurance companies of all sizes and types, stock, reciprocal and mutual, who market insurance in a variety of ways using employees, agents, or the mail.

Our members write about 40 percent of the automobile insurance in the United States, a quarter of the homeowners coverage, and lesser portions of other lines.

I have submitted a statement in writing to the committee and I would appreciate it if it were made a part of the record.

Senator **Metzenbaum**. It will be.

Mr. **Mitchell**. Thank you, Mr. Chairman.

I should like, in view of the time, to highlight two or three points in my testimony, as opposed to going through this prepared statement. It seems to me in listening to all of the witnesses, and I guess I am the last one this morning——

Senator **Metzenbaum**. This afternoon.

Mr. **Mitchell**. Yes, this afternoon is right.

The McCarran-Ferguson Act was enacted in 1945 with the statement by Congress at that time that it was their belief that the public, the consumer could best be served by having the insurance industry regulated at the State level.

In my simplistic mind, it would seem that we should be directing evidence as to whether or not that is not the state of affairs today. Has that changed? What evidence has been presented that the McCarran Act has not served its function?

I am here to say that in my opinion, in my 28 years in the insurance industry, it is alive and functioning well; that State regulation is functioning well.

There have been a number of comments alluding to the cost and availability of insurance by the Attorney General from West Virginia, for one, and from a number of other witnesses. However, repeal of the McCarran-Ferguson Act is not going to affect that one iota; it is not really.

We, Harleysville, are a small to medium-sized company. In 1986, we wrote slightly over $400 million in net written premium. We operate in 10 States—we are a regional company—including the District of Columbia.

Out of the approximately 3,500 property-casualty companies in the United States, we rank 59th in size based upon premium. That should give you an idea of the small companies that exist in this country. We only operate in ten States; we wrote over $400 million. We are 59th in size out of 3,500.

Some companies write only in one town, in one county, and if they write $100,000 in premiums for the year, that is a big deal. You are going to put them out of business.

Senator METZENBAUM. How?

Mr. MITCHELL. By repealing the McCarran-Ferguson Act. They need the services of ISO, of the NCCI, of the bureaus that give them an average, and this was quoted a moment ago by Mr. Hunter and I would like to correct that record.

This is not a rate to protect the most inefficient insurance company so that they can make a profit. It is an average rate for an average company for an average risk. All companies that submit their data to ISO are averaged. It is not geared to the most inefficient.

I see I have a red light. Mr. Chairman, needless to say, I would hope that you do not see fit to repeal the McCarran-Ferguson Act. I think it will do a great injustice to the many small insurance companies that do an excellent job in this country.

Thank you.

[Prepared statement follows:]

STATEMENT OF

BRADFORD W. MITCHELL
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
HARLEYSVILLE INSURANCE COMPANIES
AND
PAST CHAIRMAN AND MEMBER OF THE
BOARD OF GOVERNORS OF
THE NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

Mr. Chairman, members of the committee, repeal of the McCarran-Ferguson Act as proposed by Sen. Metzenbaum's bill, S. 80, will mean fewer companies and less competition, which will be harmful to the marketplace and consumers. Repeal will also mean the unwarranted imposition of dual federal/state regulation of insurers, in place of today's system of state regulation. The McCarran Act should not be repealed or changed.

I am Bradford W. Mitchell, Chairman and Chief Executive Officer of Harleysville Insurance Companies of Harleysville, Pennsylvania. I am also a member of the Board of Governors of the National Association of Independent Insurers, as well as a past chairman of NAII, and I am appearing on behalf of the NAII and Harleysville, as well as the Alliance of American Insurers and the Reinsurance Association of America.

Harleysville began in 1917 as a small insurance company. Today, Harleysville has grown to become a medium-sized, regional company writing about $405 million in net premiums in 1986.

The National Association of Independent Insurers, is a non-profit trade organization of 500 property/casualty insurance companies of all sizes and types, stock, reciprocal and mutual companies who market insurance in a variety of ways using employees, agents or the mail. Our members write about 40 per cent of the automobile insurance in the U.S., a quarter of the homeowners coverage and lesser portions of other lines.

I'm here today to tell you first-hand from my 28 years of experience in the insurance industry, that the McCarran-Ferguson Act is working well, as evidenced by a fiercely competitive property/casualty insurance market and a strong system of state regulation.

The property/casualty insurance business is extremely competitive under traditional antitrust tests. The industry is made up of a large number of competitors; there are virtually no entry barriers and concentration is low. There are about 3,500 companies in the business, with new entrants coming in almost daily. Only one company comes close to having 10% of market share. The top five companies write less than 25% of the business, and the top ten write less than 40%. Companies with under 1% of the market write more than 43% of the business.

Contrary to what some industry critics charge, the McCarran Act promotes competition. If anything, we have been accused of having too much competition. The critics can't have it both ways.

The limited antitrust exemption provided by the McCarran Act permits joint collection and sharing of loss data and other essential information so that companies can make intelligent, predictive judgments about possible future losses and adequately price their insurance products to protect company solvency for policyholders. The exemption also permits pooling agreements and sharing of hard-to-place jumbo risks vital to the efficient operation of the insurance market.

Elimination of the McCarran Act would either prohibit or hamper the joint collection and sharing of essential industry data and pooling of risks and would cause chaos in the insurance industry. All but the very largest companies would find it impossible to compete, because they could not accurately forecast the appropriate price for the product or participate in the market efficiently. The result would no doubt be a wave of mergers, with some companies opting to get out of the business altogether, thus lessening competition to the detriment of consumers.

Insurance is a unique business because, unlike other businesses, insurers never know the true cost of their product until all claims are presented and resolved. Thus, insurers price before knowing costs, whereas others evaluate costs first, and then price products. Insurers must make educated projections about future losses, economic factors, legal standards and a variety of other variables, and they often must wait years to find out if they were right or wrong. As a result, insurers must act jointly to gather every scrap of data available in order to make their estimates as educated as possible.

Here are just a few examples of how repeal of the McCarran Act would affect my company and the marketplace environment we operate in:

* For starters, Harleysville probably would not be in existence today as a medium-sized, regional company were it not for the McCarran Act which permitted us to use industrywide data to compete against the giants and to grow.

* In the future, the company would be deprived of industry data used to set rates in many lines and we would have two choices -- to somehow rely on pricing determinations made by larger companies or to "fly blind" by setting rates without the benefit of adequate statistical supporting data.

* The company could run into solvency problems as a result of following a poor leader or flying blind.

* State regulators would be impeded from adequately monitoring company rates and results.

* The company could face difficulties securing reinsurance since reinsurers depend heavily on carriers setting appropriate and statistically sound rates.

* The company could suffer through more violent industry business cycles since without standard industry data there would be no benchmarks, low or high bounds, for companies to rely on in setting rates.

* The company would likely cease doing business in some smaller states where the volume of business is not sufficient to give adequate data from which to set rates.

* The company would not be able to participate in pooling arrangements for hard-to-place risks, and they would have to be reconstituted with government (mandatory state funds) probably carrying the associated administrative burdens.

* Larger companies with better data bases would have the ability to draw off business from us because they would be better able to set rates and would be more selective.

* Innovation would be curtailed.

Thus, the limited antitrust exemption provided by the McCarran Act is essential to a healthy, competitive insurance market.

To say, as some industry critics charge, that under the McCarran Act insurers sit around a table and collectively set prices is false and demonstrates a total misunderstanding of how the industry and the law operates. For one thing, the intense competition within the industry would not permit such activity to occur.

For another, the McCarran Act provides insurance companies with a limited exemption from federal antitrust laws (i.e., Sherman, Clayton and FTC Acts),when engaged in the "business of insurance", if they are so regulated by the states. Courts have taken a restrictive view of the scope of the "business of insurance," which limits the exemption further. In addition, Federal laws prohibiting boycotts, coercion or intimidation still apply to insurers, as do general federal corporate laws dealing with taxes, labor relations, pension plans, and so forth.

The McCarran Act also recognizes a long-standing commitment by the Congress to a system of state (rather than federal) regulation of the insurance business. By virtue of the McCarran Act, states police the pricing practices of insurers and provide for consumer protection regulation generally, rather than the federal government.

I have attached to my statement an NAII booklet describing how state insurance regulation works. State regulation of insurance has served consumers' interests for years. The industry is highly competitive, as numerous studies have shown. At the same time, consumers' interests in prompt and fair handling of claims, along with regulation for solvency, are efficiently carried out by insurance regulators closest to the consumers being served--at the state level. Repeal of the McCarran Act would result in a dual system of federal-state regulation which would be duplicative, confusing, costly, and unnecessary.

Finally, I would be remiss if I did not mention that a large part of the property/casualty insurance industry's recent problems stem from the tort liability crisis around the country. Changes are needed in our legal system to bring back predictability and stability. As it stands now, the tort liability system is out of control. Insurers are losing the ability, particularly in many commercial lines, to adequately predict the future loss costs for the products they sell today. The impact has been devastating to business and consumers, particularly smaller concerns.

NAII is working very hard with the business community, and others, in state coalitions seeking to correct this situation through state level tort reform. In addition, we are working with insurance regulators and the business community to resolve specific problems in troubled lines through market assistance plans, voluntary pools and other programs. Some progress is being made, but much work remains to be done.

Repealing the McCarran-Ferguson Act will not help alleviate availability and affordability problems which are occurring in some lines of insurance. A 1986 Justice Department report provides support for our position. The Department of Justice Task Force Report on Tort Reform found little evidence the current crisis is a result of regulatory failure (either in the sense of insufficient, inadequate, or ill-conceived regulation) and no evidence that the industry's antitrust immunity is a significant factor on availability/affordability.

In conclusion, therefore, we think repeal of the McCarran Act will result in a less competitive marketplace and inefficient regulatory system which will be harmful to competition and consumers. Repeal will mean an industry now made up principally of many small companies will become more and more concentrated until a few big companies will dominate the marketplace. For these reasons, we urge the committee not to repeal or make any changes in the McCarran Act..

* * *

Senator **Metzenbaum**. I thank each of the witnesses. By reason of the hour, I have spoken with my colleagues. I do not know if any of them have a pressing question that they want to put forth. If they do, I certainly would not preclude them from doing so.

We appreciate your testimony. I want to assure you, Mr. Mitchell, that we do not intend to put any insurance companies out of business. That is not our effort. We just believe in the free enterprise system. We believe in free competition, and we believe that the largest industry in America should not be exempted from the same laws that apply to all the rest of American industry.

But some have differing points of view. We have heard from you today; we have heard from some who support that point of view. We will just have to proceed forward from there. There will be another hearing at a later date and then we will move forward with the legislation.

Before concluding, I have a letter here from the National Association of Women Business Owners, the Consumer Federation, the Environmental Policy Institute, the American Association of Retired Persons, the Women's Legal Defense Fund, the Women's Equity Action League, the National Insurance Consumer Organization, Public Citizen, the U.S. Public Interest Research Group, and the Consumer's Union. That letter will be included in its entirety in the record.

[The following was received for the record:]

February 17, 1987

Honorable Howard Metzenbaum
Chairman
Antitrust Subcommittee
Senate Judiciary Committee
Russell Building
Washington, DC 20510

Dear Senator Metzenbaum:

We are writing to urge that during the 100th Congress you carefully scrutinize the McCarran-Ferguson Act, which exempts the insurance industry from the antitrust laws and thus allows insurance companies to fix prices. If such scrutiny leads Congress to conclude that the current broad exemption for price-fixing is unnecessary or harmful, then we believe McCarran-Ferguson antitrust immunity should be substantially narrowed or repealed.

There has traditionally been bi-partisan support for narrowing or repealing McCarran-Ferguson. Under President Ford, for example, the Department of Justice exhaustively studied the insurance industry and concluded that "an alternative scheme of regulation, without McCarran Act antitrust protection, would be in the public interest." It found that absent the McCarran Act's authorization of price fixing, necessary collective activities such as joint loss data collection and insurance pools and reinsurance agreements could continue. U.S. Department of Justice, The Pricing and Marketing of Insurance, at viii (1977).

Similarly, in 1979 President Carter's National Commission for the Reform of Antitrust Laws and Procedures, composed of the nation's leading antitrust experts, concluded almost unanimously that McCarran-Ferguson's broad antitrust immunity should be repealed. In its stead the Commission recommended narrowly drawn legislation to affirm the lawfulness of a limited number of essential collective activities. The Commission also recommended that the states place maximum reliance on competition in pursuing their regulatory objectives. Report to the President and the Attorney General of the National Commission For the Review of Antitrust Laws and Procedures, Jan. 22, 1979, at 225.

Finally, the present administration has also concluded that the current broad McCarran-Ferguson exemption fails to maximize consumer welfare, as Federal Trade Commission Chairman Dan Oliver has recently indicated. See, e.g., Statement of Dan Oliver, Chairman, Federal Trade Commission, before the National Association of Insurance Commissioners, Dec. 10, 1986.

While the undersigned groups come from widely different perspectives, we all believe that the current broad McCarran-Ferguson antitrust exemption is at best unnecessary. Unless the insurance industry is subjected to the antitrust laws, we are concerned that the practices of some insurance companies, such as sudden massive price increases in certain lines of insurance for particular groups, or discriminatory rating on the basis of sex, will continue. We look forward to working with you on this important issue.

Hope Eastman
Vice-President,
Government Affairs
National Association of
Women Business Owners

Gene Kimmelman
Legislative Director
Consumer Federation

Keike Kehoe
Nuclear Accountability
and Insurance Project
Director
Environmental Policy Institute

Sana Shtasel
Director of Federal
Affairs
American Association of
Retired Persons

Judith Lichtman
Executive Director
Women's Legal Defense Fund

Pat Reuss
Legislative Director
Womens Equity Action
League

Joe Goffman
Staff Attorney
Public Citizen

J. Robert Hunter
President
National Insurance
Consumer Organization

Pam Gilbert
Staff Attorney
U. S. Public Interest
Research Group

Linda Lipsen
Legislative Counsel
Consumers Union

Senator **Metzenbaum**. With that, that concludes our hearing for today. I appreciate the patience of all of you who have borne with us this morning as well as this afternoon.

[Whereupon, at 1:53 p.m., the committee was adjourned.]

S. 1299—TO REPEAL THE ANTITRUST EXEMPTION FOR THE BUSINESS OF INSURANCE

TUESDAY, JUNE 2, 1987

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 9:45 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Howard Metzenbaum presiding.

Also present: Senators Thurmond, Grassley, and Humphrey.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator **METZENBAUM**. The hearing will come to order.

Today, we continue our consideration of legislation to repeal the insurance industry's exemption from the antitrust laws. Since this committee's first hearing on this subject in February, I have met with industry representatives and listened to their concerns about S. 80, my initial bill to apply the antitrust laws to insurance.

They told me they believed I wanted to substitute Federal for State regulation of insurance. I told them nothing could be further from the truth. They also told me that certain joint activities such as sharing loss data were essential to the business of insurance and had to be immune from the antitrust laws. I told them I would do all I could to meet their concerns.

I have. Last week, I introduced S. 1299, a revised approach to repealing the antitrust exemption for insurance. I am gratified to be joined in this effort by Chairman Biden and Senators Simon and Kennedy. Now that we have moved, I would hope that the insurance industry would move with respect to its opposition.

Our bill states in the clearest possible terms that State regulation of insurance continues to be in the public interest. It also carves out safe harbors for sharing loss data and certain other joint activities which are not anticompetitive and are essential to the business of insurance.

S. 1299 enjoys the support of a remarkably diverse coalition. This morning, representatives of the American Bankers Association, physicians, nurses, small business, labor, State legislators, State attorneys general, businesswomen, lawyers, senior citizens, and consumers endorsed the bill.

More than ever, it is only the insurance industry itself, that great guardian of the free enterprise system, which continues to stand up and speak out against the free enterprise system being permitted to work freely in our economy.

It is aggressively lobbying to preserve its own self-interested exemption from the antitrust laws, and I say it is regrettable because the insurance industry should not be the bad guys of the free enterprise system.

There is no industry in America that is more powerful and has more impact upon the economy than does the insurance industry. If it is to stand up and speak out for free enterprise, if it is going to spend all of its dollars on national TV and on radio and newspaper ads talking about the free enterprise system and talking about free competition, then it also should be talking about repealing the antitrust exemption in the McCarran-Ferguson Act.

I do not underestimate the political clout of this industry, nor do I underestimate the number of dollars which it has available. When insurance companies speak, Congress listens.

Interesting to this Senator was one insurance company that had earlier in the session spoken out about doing some support work for my own campaign effort, but as of this moment they have made it very clear they have reversed their field. So be it; we will live without it.

Because a special interest is powerful does not mean that it is right. Preserving insurance companies' exemption from the antitrust laws will serve one interest, and one interest alone, their own.

I understand the industry has formed a lobbying group which calls itself the Coalition for State Regulation of Insurance. That is a joke, it is a fraud, it is a phony. The industry is not for State regulation. When tort reform is the issue, it is for Federal regulation.

Even though my legislation makes clear that State regulation would continue, the industry still opposes it. On McCarran-Ferguson, the industry supports one basic principle, the perpetuation of its exemption from the rules of free competition and fair play.

There is no reason on earth why anti-consumer, anti-competitive behavior of insurance companies should not be accountable to the antitrust and consumer protection laws of this country.

It is past time to repeal the exemption that allows such behavior to flourish at the expense of consumers and honest competitors. S. 1299 is a responsible and long overdue step in the right direction.

I would say to those in the insurance industry that no matter what the forum, I would be pleased to debate the issue with you publicly, provided that all of the public would have an opportunity to know of the consequences of that debate and to be present to hear it or to know that the issue was being debated.

I am so confident that the position of this Senator and my cosponsors of this legislation is right that I would welcome the debate, whatever the forum. I look forward to working with my colleagues on this committee and the full Senate in making this bill the law.

We have a statement from the Chairman of the Committee, Senator Biden, which we will insert in the record at this point.

[Prepared statement follows:]

PREPARED STATEMENT OF CHAIRMAN JOSEPH R. BIDEN, JR.

The liability insurance crisis has touched almost every person and every business in this country.

The skyrocketing costs of insurance and, in some cases, the inability to obtain insurance at any price, is a crisis shared by everyone—big business and small business, doctors and patients, corporate executives and factory workers, men, women and children alike. It has forced dramatic changes in the legal protections afforded people injured through the negligence of another and threatens public confidence in our civil justice system.

In the past, some have proposed sweeping changes in tort law—particularly product liability law—as the answer to this problem. But it becaome clear that insurance rates would not drop if we curtailed victims' legal rights. So this year, we have taken a different approach on the Judiciary Committee. We examined one of the root causes of the insurance crisis—the insurance industry's immunity from prosecution under the antitrust laws.

Several times in the past, the Justice Department has recommeded that the antitrust immunity enjoyed by the insurance industry be repealed or limited, but nothing has been done. The hearings we held have demonstrated that the industry must become accountable under our antitrust laws if the liability insurance crisis is to be solved.

That is why I am pleased to join Senator Metzenbaum today in cosponsoring legislation to reform the McCarran-Ferguson Act. The bill we are introducing today is a start in the right direction. This is a complex issue. We will need the help of all the interests affected by this legislation to accomplish the right result.

We do not intend to overturn the system of state insurance regulation that has governed this industry for almost 100 years. What we do intend is to subject the insurance industry to appropriate scrutiny under the federal antitrust laws, while allowing necessary joint activities to continue. To achieve this result may take some time and careful thought, but it is important that we begin this process now.

Senator METZENBAUM. We have a long list of witnesses today and so I will ask each of the witnesses to limit themselves to 5 minutes, and when I say 5 minutes, I mean 5 minutes.

Mr. Frank Swain, Chief Counsel of the Small Business Administration, we are happy to have you with us, sir.

STATEMENT OF A PANEL CONSISTING OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC.; AND MICHAEL A. HATCH, COMMISSIONER, DEPARTMENT OF COMMERCE, STATE OF MINNESOTA, BURNSVILLE, MN

Mr. SWAIN. Thank you, Mr. Chairman. I am happy to be here and present the views of the Small Business Administration Office of Advocacy. As you may know, the Office of Advocacy was created by Congress in 1976 to represent within the Federal Government the views of small business on policy issues.

I should point out that the Department of Justice speaks for the administration formally on antitrust issues, and so my role here this morning is to address the concerns of small employers who have been hit hard by the current insurance crisis.

Certainly, in previous hearings you have heard several witnesses representing small business groups and associations complain about insurance. There is no need to recapitulate that testimony.

I would emphasize that the 1,823 delegates to the 1986 White House Conference on Small Business identified liability insurance problems as their top priority. Given all the various things that small business might worry about—financing, exporting, regulation of various types—they remarked that liability insurance prices was the number one priority.

Now, the major attention for small business in that recommendation—which is attached to our statement—as it should be for the Congress, is civil justice reform. However, the recommendations specifically called for review of the McCarran-Ferguson Act as it applies to State regulation of insurance and a limited exemption from Federal antitrust laws.

I think it is important not to draw the conclusion that the small business community believes that repeal or modification of McCarran-Ferguson standing alone will solve all the problems that there are today concerning the current tight insurance market.

Tort reform has a very high priority as something that is important for the Congress to do and for State legislatures to do as well. But small businesses are not policy experts and they are not interested in trading off one against the other. They are interested in any and all efforts that the Congress can make to solve the problems that we have at hand in the insurance system.

While our review of the McCarran-Ferguson Act suggests that repeal of the antitrust immunity will not by itself solve all of the small business concerns with the marketplace, we do not find any overriding public policy reasons for maintaining the antitrust immunity as it now stands.

We fully support the position of the Department of Justice before this and other congressional committees and we welcome the committee's review. Small businesses generally do not benefit when there are broad exemptions made to the antitrust laws. The burden of justifying exemptions and properly designing such exemptions must be on those who assert the need for the immunity.

As Congress revisits the McCarran-Ferguson Act, you are likely to hear much discussion of the small business benefits of immunity, benefits to small business customers or insurance providers. I urge you to be skeptical of those claims.

Small firms thrive in competitive markets and the insurance market does not appear to be so different from other markets. At the same time, I urge caution when you are told that reform in this area will solve the liability insurance crisis. The crisis resulted from many factors. The antitrust immunity did not, in my view, cause the crisis.

Specifically, the evolution of the antitrust doctrine since 1945 suggests that McCarran-Ferguson can be modified to be consistent with continued State regulation and to allow for necessary joint insurer activities.

Given the likely continued validity of many forms of collective behavior by the insurance industry, because such behavior meets the State action doctrine or, in fact, does not restrict trade, only truly anti-competitive activities that are not supervised by the State will run afoul of Federal antitrust laws.

Subjecting private collective activities to Federal antitrust laws should benefit small businesses and other consumers of insurance by promoting efficiency and competition, and it should benefit small providers by creating a more competitive market.

Specifically, we strongly oppose the complete repeal of McCarran-Ferguson and do endorse the general approach of various pieces of legislation, including that that you introduced yesterday, to specifically demarcate particular activities which are justifiable, although they are collective in nature.

Obviously, the specific wording of those presents a great challenge and reasonable people can disagree about what that list of activities is. However, we do believe that a focused grant of immunity for certain insurance activities is appropriate.

We believe that increased regulation of insurers, particularly in response to the artificial stimulus of a Federal statute, would not promote competition, and therefore we urge the committee to pay careful attention to ensure that the committee does not by its definition require increasing State regulation in order to permit certain activities that are now not closely scrutinized by the States, such as rate-making in certain circumstances—for instance, a file-and-use situation. I think there is a reasonable question as to whether under a file-and-use procedure, there is the proper amount of State action that would be needed to exempt the activity. I urge the committee to pay close attention to such questions.

In particular, we also urge the committee to carefully gauge the effect of any legislation on small carriers. We believe that inclusion of a data collection element in any legislation modifying McCarran-Ferguson will be helpful and necessary for continued small carrier competition.

In addition, we urge the committee to consider whether it might well be appropriate to include in the list of permissible activities the publication of pure premium rates, which is simply an actuarial suggestion of what the rates ought to be.

Finally, we believe that modification of McCarran-Ferguson and review by the committee is a positive step and we endorse the committee's general approach and would like to continue working with the committee.

[Prepared statement follows:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

STATEMENT OF

THE HONORABLE FRANK S. SWAIN

CHIEF COUNSEL FOR ADVOCACY

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

SENATE COMMITTEE ON JUDICIARY

June 2, 1987

Mr. Chairman:

Thank you for the opportunity to present the views of the U.S. Small Business Administration, Office of Advocacy on proposals to modify the McCarran-Ferguson Act of 1945. As you may know, the Office of Advocacy was created by Congress in 1976 to represent the interests of small business before Congress and Federal agencies. The Department of Justice speaks for the Administration on antitrust issues; my role is to address the concerns of small employers who have been hit hard by the current insurance "crisis."

1. Small Business Perspective

The difficulties small businesses face in obtaining suitable and affordable liability insurance should come as no surprise to the Committee. Over the past two years the Office of Advocacy has received numerous complaints from small employers reporting dramatic premium increases, unavailability of policies and reductions in protection. Small businesses have raised prices, laid off workers, and cut back on products and services in response to expensive and/or insufficient protection. The most disturbing accounts come from small businesses that have shut down because of insurance problems, and would-be small businesses that never got off the ground because of the high cost and scarcity of insurance.

The 1,823 delegates to the 1986 White House Conference on Small Business identified liability insurance problems as their top priority for legislative action. In response to the insurance problem, the delegates asked for a comprehensive solution. The major focus of attention for small business--as it should be for the Congress--is civil justice reform. However, the recommendation specifically called for review of the McCarran-Ferguson Act as it applies to state regulation of insurance and the limited exemption from Federal antitrust laws. A copy of the complete recommendation is appended to my statement.

Small business support for reviewing McCarran-Ferguson is also evident from the presentations before this Committee by the National Federation of Independent Business (NFIB) and the Small Business Legislative Council (SBLC).[1] A poll of NFIB's membership revealed that 60 percent favor repeal of McCarran-Ferguson's antitrust immunity. Members of the SBLC ranked review of McCarran-Ferguson as their fifth legislative priority out of twenty in 1987.

It is important, however, not to draw the conclusion that the small business community believes that repeal or modification of McCarran-Ferguson standing alone will significantly affect the current tight insurance market. The White House Conference delegates, as well as NFIB and SBLC members, also asked for comprehensive tort reform, with a very high priority placed on a Federal product liability standard. Small employers do not have strong views as between these policy options; small employers want continuous access to affordable and adequate liability insurance and do not particularly care how that result is achieved. Any and all measures designed to provide relief are welcome by the small business community.

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[1] See statements of John Motley, Director of Federal Legislation, National Federation of Independent Business and John Satagaj, President, Small Business Legislative Council before the Senate Committee on Judiciary, February 18, 1987.

2. Modification of McCarran-Ferguson

While our review of the McCarran-Ferguson Act suggests that repeal of the antitrust immunity will not by itself, solve all of the small business concerns with the insurance marketplace, (and, in fact, may occasion new costs to insurers and temporarily increase the price of insurance as insurers adjust to changes in the legal environment and marketplace), we do not find any overriding public policy reasons for maintaining the antitrust immunity as it now stands. We fully support the position of the Department of Justice before this and other Congressional committees.[2]

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[2] See statement of Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, U.S. Department of Justice before the Senate Committee on Judiciary, February 18, 1987. See also statements of Charles F. Rule before the House Committee on Judiciary, April 23, 1987 and before the House Committee on Small Business, April 29, 1987.

We welcome the Committee's review of the continued need for the insurance industry's antitrust immunity. Small businesses generally do not benefit when broad exceptions are made to the antitrust laws. The burden of justifying exemptions and properly designing such exemptions must be on those who assert the need for the immunity. Congress must draw the exemption as narrowly as possible. Thus, I believe that the current immunity can be narrowed significantly. Were Congress addressing this issue for the first time today, I suspect the original McCarran-Ferguson law would be more targeted.

As Congress re-visits the McCarran-Ferguson Act you are likely to hear much discussion of the small business benefits of immunity, benefits to small business customers or insurance procedures. I urge you to be skeptical of those claims. Small firms thrive in competitive markets and the insurance market does not appear to be so different from other markets.

At the same time I urge caution when you are told that reform in this area will solve the liability insurance crisis. The liability insurance situation resulted from many factors; the antitrust immunity did not, in my view, cause them. Resolving insurance problems in the long run will be much more significantly affected by appropriate reform of the civil justice system.

While review of the McCarran-Ferguson Act's antitrust immunity is appropriate, I do not believe that any move toward Federal regulation is warranted. There are undoubtedly many complicated issues currently facing state regulators and, while the complexities would increase if Federal antitrust immunity is narrowed, there is no reason to believe that Federal regulation would provide a better solution. I would oppose any steps in that direction.

a. Reasons for Reconsidering the McCarran-Ferguson Antitrust Immunity

A major argument in favor of repeal or modification of McCarran-Ferguson is that the reasons for its passage in 1945 are no longer relevant today. Congress enacted the McCarran-Ferguson Act largely in response to a 1944 Supreme Court ruling that the business of insurance constituted "interstate commerce."[3] Prior to 1944, an 1869 Supreme Court ruling held that the business of insurance was not "interstate commerce" and, therefore, not subject to Congress' oversight.[4] To ensure the continued tradition and validity of state regulation and taxation of insurers, Congress passed the McCarran-Ferguson Act, which confirmed the states' regulatory authority and provided a limited exemption from Federal antitrust laws.[5] In enacting McCarran-Ferguson, Congress also wanted to make sure that certain collective activities viewed as necessary for efficiency in operations were not prohibited by application of Federal antitrust law.

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[3] U.S. v. South-Eastern Underwriters Association, 332 U.S. 533 (1944).

[4] Paul v. Virginia, 15 U.S. (8 Wall.) 168 (1869).

The evolution of antitrust doctrine since 1945, however, suggests that McCarran-Ferguson can be modified to be consistent with continued state regulation and to allow for joint insurer activities. First, the evolution of the "state action doctrine" since 1945 clarifies the states' ability to sanctify otherwise anticompetitive behavior, so long as the state clearly articulates its regulatory scheme and actively supervises the activity. Second, the development of antitrust doctrine over the years suggests the validity of joint activities aimed at efficiency that previously might have been perceived as violative of antitrust laws. Therefore, many collective activities can occur consistent with application of antitrust laws; even where joint conduct does not meet the rigors of the state action doctrine, truly non-anticompetitive collective activities can pass muster under the law. Collective insurer activities that generally are not viewed as anticompetitive include some sharing of loss data, policy forms, and joint underwriting.

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[5] 15 U.S.C. 1011 _et_ _seq_.

Given the likely continued validity of many forms of collective behavior by the insurance industry--because such behavior meets the state action doctrine or, in fact, does not restrict trade--only truly anticompetitive activities that are not supervised by the state will run afoul of Federal antitrust laws. Subjecting private collective activities to Federal antitrust laws should benefit small businesses and other consumers of insurance by promoting efficiency and competition. It will benefit small providers by creating a more competitive market, one in which small firms can thrive.

b. Legislative Approach

The Office of Advocacy strongly opposes the complete repeal of McCarran-Ferguson, which would appear to open the door for Federal or dual regulation of insurance. We strongly support the continued authority of the states to regulate the insurance industry.[6] If, however, it is appropriate to alter the McCarran-Ferguson Act we believe that consideration should be given to a more focused grant of immunity. For example, Congress could modify only the provisions relating to the antitrust exemption and enumerate with greater specificity the joint activities that are viewed as consistent with antitrust laws. While it may not be legally necessary to specify permissible joint conduct, such an approach could reduce uncertainty and some of the inevitable litigation that will follow in the wake of repeal.

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[6] This view appears to be supported by the small business community. In response to an NFIB poll of its membership, 67 percent opposed and 26 percent favored Federal minimum standards for insurance.

Specifically, the enumeration of allowable joint activities would provide guidance to states in regulating insurers and prevent unnecessary and anticompetitive over-regulation. If allowable conduct is not spelled out in the Federal statute, states might attempt to immunize the conduct by increasing regulation to ensure meeting the requirements of the state action doctrine. We believe that increased regulation of insurers, particularly in response to the artificial stimulus of a Federal statute, would not promote competition. Because some joint activity may well be pro-competitive and legal under existing antitrust laws, we would oppose an approach which conditioned the legality of joint conduct on the active supervision of state regulation, a result clearly antithetical to competition.

We encourage the Committee to be as inclusive as possible as to such activities, so as to minimize uncertainty and disruption to the normal business practices of the insurance industry. We urge the insurance industry to come forward and work with the Committee, describing joint activities that are needed for efficiency and effective competition.

c. Effect on Small Insurance Companies

While larger insurers are able to generate sufficient loss data to assist in making rates, smaller companies have insufficient data bases and need to rely on data collected industry-wide. We believe that inclusion of a data collection element in any legislation modifying McCarran-Ferguson will be helpful for continued small business competition.

The scope of data should be carefully considered and drawn narrowly. Shared data collected by the industry which takes into account losses or events that enable firms to make their individual business decisions may woll be appropriate. On the other hand, I question the need to share information on expenses (i.e. taxes, acquisition costs, settlement expenses, general overhead expenses), as expense items are the very factors on which insurance companies may compete.

In addition, we urge the Committee to consider whether it might well be appropriate to include in the list of permissible activities the publication of "pure premium" rates. Such rates would not include carriers' administrative expenses, but would include actuarial assessments of risk based on shared loss data that would be permissible to collect and disseminate under the bill. In the absence of such information, small companies, which lack in-house actuarial resources, would have higher costs if they were compelled to hire a third party to determine rates. (While insurance carriers currently pay for the services of ISO or a similar organization, we would expect that certain economies of scale are achieved by going through such large providers). Over time, however, we would expect small insurers' costs to adjust, as competition increased among those providing insurance actuarial services.

3. Conclusion

In conclusion, while we do not believe that modification of the McCarran-Ferguson Act will, by itself, have a marked effect on the current insurance marketplace, we do not see the need for the insurance industry to enjoy a broad exemption from Federal antitrust laws. If there are reasons that such an immunity is needed to promote efficiency in operations and competition, we believe the burden is on the industry to come forward and justify the exemption. If Congress is to proceed with legislation on this issue, we support an approach which retains state regulatory provisions and enumerates joint conduct viewed as consistent with antitrust laws.

Finally, we urge the Committee to consider civil justice reform. The Committee is not responding to the small business community as long as it fails to review the contribution of the civil justice system to problems in the insurance marketplace. In the long run, reform of the civil justice system will have a far more significant impact on the insurance market than modification of the McCarran-Ferguson Act.

Thank you for the opportunity to present my views. I would be happy to provide the Committee with any further information.

FINAL RECOMMENDATIONS

WHITE HOUSE CONFERENCE ON SMALL BUSINESS

1 Because the liability insurance crisis in the United States has not only become a life and death sentence to many small businesses, but also is changing adversely our way of life, we must pursue a four-pronged effort at reform: civil justice reform; uniform standards for product, professional, and commercial liability; regulation of the insurance and reinsurance industries; and viable affordable alternatives to liability coverage.

We, therefore, strongly urge the President, the Congress, and the state legislatures to implement the following action as a vitally important step in alleviating the problems of availability and affordability of liability insurance to small business in America:

a. Civil Justice Reform:

1. Return to a fault-based standard of liability.

2. Base causation findings on credible scientific and medical evidence and opinions.

3. Eliminate joint and several liability in cases where defendants have not acted in concert.

4. Limit non-economic damages (such as pain and suffering, mental anguish, or punitive damages) to a fair and reasonable maximum dollar amount, not to exceed $250,000 in any case.

5. Restrict punitive damage awards to cases of willful and malicious conduct. The amount awarded shall go to a governmental trust fund, not the plaintiff.

6. Limit attorney contingency fees to reasonable amounts, on a sliding scale.

7. Reduce awards in cases where a plaintiff can be compensated by certain collateral sources, to prevent windfall double recovery.

8. The prevailing party in a legal action should have a statutory right to recover costs and attorney fees from the non-prevailing party.

9. Impose a uniform, reasonable statute of limitations and repose in all tort actions, and hold defendants to the state-of-the-art in existence at the time a product was manufactured or a service was performed.

10. Provide for periodic instead of lump-sum payments for future medical care or lost income.

11. Encourage use of alternative dispute resolution mechanisms to resolve cases out of court.

b. Federal Standards for Product, Professional, and Commercial Liability: Establish a uniform standard of fault-based product, commercial, and professional liability which incorporates provisions cited in "Civil Justice Reform," above.

c. Availability and Affordability of Liability Insurance and Reinsurance:

1. Review McCarran-Ferguson Act of 1945 as it applies to state regulation of insurance and the industry's limited exemption from antitrust laws.

2. Promote the establishment of joint underwriting associations and assigned risk pools.

3. A minimum of 60 days notice should be required if an insurer decides not to renew a policy or to increase its unit premium by more than 25 percent. Mid-term cancellations should be prohibited and premiums should be based on experience ratings.

4. Promote tax-deductible self-insurance through risk pooling and other group arrangements, including the expansion of the Risk Retention Act of 1981.

5. Legislate a self-insurance system that would allow small businesses to pay premiums into a fund with pre-tax dollars. The fund could be used for no other purpose than the payment of claims, with the fund being regulated in the same manner as any other insurance company.

6. Require the insurance industry to make complete financial disclosures by lines of insurance, so that Congress, state legislatures, and state insurance commissioners may call on this information at any time.

d. Education: Realizing that the most effective long-term solution to the liability insurance problem is a knowledgeable citizenry, we urge an ongoing education program to develop an awareness that:

1. The litigious nature of the American public will profoundly affect our way of life as the cost of public and private facilities becomes unaffordable.

2. There is no such thing as a riskless society, so each of us must assume some responsibility for his/her own safety and the normal hazards of everyday living.

[*1,419 votes of 1,715 ballots cast*]

Senator **Metzenbaum**. Mr. Swain, I want you to know we very much appreciate your support and many of the suggestions you have made and we are very happy to continue working with you. We are pleased about the fact that this is one of the higher ranking issues of concern to the National Small Business Legislative Council and to the National Federation of Independence Business membership, indicating what a major concern it is for small business in this country.

It pleases us that you have seen fit to come here this morning and speak out in support for our legislative approach, and we also note the fact that you say in your statement that it's important to be skeptical of those who claim that repealing the exemption might harm the small business community.

I think your statement is, "As Congress revisits the McCarran-Ferguson Act, you are likely to hear much discussion of the small business benefits of immunity, benefits to small business customers or insurance procedures. I urge you to be skeptical of those claims." We appreciate that comment on your part.

I do not think I have any further questions of you. I do not know whether Senator Thurmond has any and, if not, we will hear from Mr. Hatch and then I will ask Senator Thurmond for an opening statement.

In fact, unless you have questions of Mr. Swain——

Senator **Thurmond**. Mr. Chairman, to save time I would just ask to put my opening statement in the record. It is very brief. We might hear from Mr. Hatch and then I may have a question for both of them.

Senator **Metzenbaum**. Very good. Thank you very much. It will be included.

[Prepared statement follows:]

PREPARED STATEMENT BY SENATOR STROM THURMOND

Mr. Chairman, today's hearing on the McCarran-Ferguson Act is the second hearing we have held to consider repeal of this Act. Since the February 18th hearing before this Committee, a number of additional bills, inlcuding the new bill just introduced by the Chairman, have been discussed by members of the Judiciary Committee. As you know, Mr. Chairman, I do not favor repeal of this Act because I do not favor any reduction in the ability of the States to regulate the insurance business. Nevertheless, I intend to review with care those proposals which purport to reduce the antitrust immunity of the insurance industry without diluting or disrupting the authority of the states.

Thank you, Mr. Chairman. I look forward to the testimony of the witnesses, and I thank them for appearing here to contribute to our deliberations.

Senator **Metzenbaum**. Mr. Hatch, if you would be good enough to identify yourself, please proceed.

Mr. **Hatch**. Mr. Chairman and members of the committee, my name is Mike Hatch and I am Commissioner of the Department of Commerce for the State of Minnesota. The statement is rather lengthy. I think it is about 14 pages long, so I will quickly try to summarize it.

Senator **Metzenbaum**. All of the statements of all of the witnesses will be included in their entirety in the record.

Mr. **Hatch**. Basically, my perspective, of course, is coming from a State angle as a regulator of the insurance industry. Insurers historically argue that they need the exemption to the antitrust laws in order to exchange premium and loss data.

They say that the public purpose of this exemption and the exchange of the data is that losses become more predictable and insurers' insolvency less likely to occur. I believe that this public interest may not necessarily be served by the antitrust exemption and I do believe that there are better alternatives to achieve the goal of insurers' solvency.

Basically, what the statement relates to is three basic areas. One is personal lines coverage, and we do know that in that area, competition is and ought to be the primary regulator of rates. I cite examples in the statement; for instance, National Farmers Union Insurance where the agents, because of the competitive pricing going on within the State, encouraged the company to lower their rates. Personal lines rates are based more on competitors rates than on ISO or other rate organization data. It is very common knowledge in Minnesota, and I assume in many States, that larger companies really set the rates as opposed to any rating organization.

Similarly, with policy provisions themselves with regard to common forms in personal lines, we have, as I mentioned in the statement, over 500 feet of filings per year in insurance, which by itself speaks to the fact that there is not necessarily any common uniformity of forms that goes on in the marketplace.

It seems to me that if you do not have any uniformity with regard to pricing or the contractual provisions of the product, then what is the purpose of these rating organizations in terms of the public interest?

My concern there is the fact that you can have inappropriate discussions. It becomes a communication web and can indeed have a negative effect on the public interest, and I guess my perspective on that is in the commercial lines area with regard to the claims-made policy.

I do relate an anecdote where companies were very open about the fact, meeting with my office, and I know they met in other States as well, basically saying they would withdraw from the State unless certain forms were approved. These were forms which I do not believe were in the best interests of the business community. They would have been anti-competitive.

Senator METZENBAUM. Could you spell that out just a little bit, without moving in on your time, about demanding that you approve certain forms or else they would withdraw from the State?

Mr. HATCH. They were a little more sophisticated than that statement, but basically in about 1985 the big push by the insurance industry in the commercial general liability area was the adoption of the claims-made policy.

I believe that the claims-made policy is very anti-competitive, not so much with regard to the beginning when the policy is sold, but several years after. When you try to price products as a businessman and you try to shop and compare, you cannot do it because you are going to have this problem with a tail that you have got to buy from one company or you are going to have to buy what is called nose coverage from the other. It gets to be a very sophisticated process in terms of trying to price the product. It is very anticompetitive.

There are other reasons and other problems with the policy as well. Nevertheless, when the policy was rejected in Minnesota in January of 1986—I had rejected it—it became very clear to me from companies through their agencies and indeed through businesses that would call up basically saying we are not going to sell until Hatch approves the policy.

Finally, in April or May—I think we were the last Midwestern State to approve it—in April or May of 1986, I did approve it. I finally approved it. Fortunately, it has not quite received the acceptance in the marketplace that I think the industry expected that it would receive. But there is no doubt that I think that experience was a negative experience in terms of any public interest impact in the marketplace.

That gets to the other area. There are basically three areas I am talking about. One is personal lines where I think basically you do not need the antitrust exemption. Second is in the speciality commercial lines where we have had this extreme change in the marketplace, as the people testified or discussed at the press conference earlier with regard to their experiences and the volatility of the rates.

Those industries are so small, so specialized that there is no ratemaking organization I am aware of that has accurate data to project any reasonable figures. I point out in my testimony experiences with regard to day care coverage, dram shop or liquor liability coverage, as well as governmental entity coverage where ratios filed with the State commissioners basically were not credible when I used those in legislative testimony in the State of Minnesota, the ISO office was the first one to say, hey, that data is not credible; it is too small. Veterinarians—for example; 42 States have the same rate, 6 have another rate. There is no real rationale given.

Now, finally, you get into the CGL, or commercial general liability area, where there is an exchange of rate data and then you run into the negative experience of the claims-made policy, and that is the third area in my testimony.

Senator METZENBAUM. What does that mean, claims-made policy?

Mr. HATCH. The coverage that most people are acquainted with in personal lines is occurance coverage—your insurance policy covers all claims occuring during the year that the insurance policy is in effect.

A claims-made policy covers claims that are reported during the year. Unfortunately, the claims-made policy that is filed and sold in most States is not a true claims-made policy because it says we only insure for claims on events that occur during the year as well, starting with the initial day of inception of the policy.

[Prepared statement follows:]

STATEMENT OF MICHAEL A. HATCH
COMMISSIONER OF COMMERCE
STATE OF MINNESOTA
June 2, 1987

Mr. Chairman, Members of the Committee, my name is Michael Hatch and I am Commissioner of the Department of Commerce for the State of Minnesota. The Department of Commerce is charged with the regulation of banks, savings and loan associations, thrift institutions, credit unions, insurance companies, securities, real estate, franchises, charities, and other financial related industries. I believe we are unique as a state regulatory agency, in that we are divided into three functional divisions as opposed to industry related divisions. The three main divisions are Examinations, Registration and Enforcement.

I have been Commissioner since January, 1983. Prior to that time I was an attorney in private practice for approximately ten years, working principally in commercial law.

Insurance is composed of the largest institutions in America. Their financial product is the insurance policy. By statute or regulation all of us at one time or another must purchase the product. At the state level automobile drivers are required to have insurance and employers must have workers' compensation insurance. At the federal level the ICC and other agencies require the various transportation industries to have insurance. Municipalities, counties, states and the federal government all require contractors to have insurance in order to make bids. Liquor vendors, day care providers, banks and real estate agents must have insurance in order to get a license.

Even in areas where the government does not mandate that we purchase the product, the product is still a necessity due to the demands of the commercial market place. For instance, property insurance must be purchased to place a mortgage; malpractice coverage must be purchased to practice in a hospital.

Insurers historically argue that they need an exemption to the antitrust law in order to exchange premium and loss data. They say the public purpose of the exemption and the exchange of data is that losses become more predictable and insurers insolvency is less likely to occur.

One might question whether this public interest is served by the antitrust exemption, and whether there are better alternatives to achieve the goal of insurers' solvency.

A. IN PERSONAL LINES, INSURANCE CARRIERS RELY ON GOVERNMENT FILINGS OF COMPETITORS MORE THAN ON RATE ADVISORY ORGANIZATIONS. THEREFORE, DATA COLLECTED BY RATE ADVISORY ORGANIZATIONS IS NOT HELPFUL TO THE PUBLIC INTEREST OF INSURER SOLVENCY.

Independent filings represent 85% of the automobile and homeowners business in Minnesota. While many of these companies are members of rating organizations, it is obvious these organizations are not necessary in order to achieve a credible data base. The state Insurance Department would be a far more appropriate place to gather data.

Indeed, insurance carriers seem to regularly follow the lead of market makers. For instance, National Farmers Union Insurance Company recently filed a rate increase for automobile and farm liability insurance in Minnesota. Their agents, however, noted that the pricing was such that they would lose market share to State Farm and Farmers Insurance if the rate increase occurred. The agents also noted that the loss ratio for Farmers Union in Minnesota was under 45% for each of the past three years. After pressure from agents, Farmers Union changed their rate. Farmers Union is a member of ISO. It is well known in Minnesota that a State Farm filing has more of an effect on automobile rates than any advisory organization.

With regard to forms, companies often deviate from standard contracts and are continually testing the market place. They have shown by their own action that they do not need the anti-trust exemption. Examples of innovative provisions include:

1. Replacement to Code Provisions: We have had a case where an insurer's replacement policy will not replace damaged property to meet building code specifications if the damaged property had not previously met code requirements.
2. DWI Coverage Excluded on Collision Coverage: One insurer offers a discount package to its insureds who agree that, if the automobile is damaged at a time when the driver

is under the influence of alcohol, no collision coverage is present.

3. Mid-Term Cancellations: Many policies have different provisions with regard to earned premium, mid-term cancellation penalties, etc.

It seems to me that, if uniform forms are to be used, particularly on products that are statutorily mandated to be purchased by businesses and consumers, the provisions should be drafted by the State, or should be drafted in a competitive fashion.

An insurer need not be a member of an rate advisory organization to obtain necessary expertise in the drafting of policies. It is fairly obvious that many insurance carriers merely copy the forms of other companies that have filed their policies with the State. Many of the analysts in our office recall reviewing policies filed by a company which, in the midst of its contract, referred to itself as the "St. Paul Companies," or some other insurer. Obviously the person who had drafted the policy had been working from a St. Paul policy contract (or a different company) and had failed to change the name of the insurer in the redrafting.

One could say that, if people copy forms filed with various insurance departments then what is the harm in having an advisory organization composed of insurance companies conduct centralized drafting. The harm is that these advisory organizations end up being a communications web for discussions as to contractual provisions which may not necessarily, in many cases will not be, in the public interest. Rather, they may be to protect the insurance carrier in many cases from competitive incentives to offer a product which the public wants. It seems to me that, if insurance companies need the protection and collective wisdom of uniform drafted contracts, it again should be done under the direction of the state.

The fact that there are over 40,000 property and casualty filings each year in Minnesota indicates that solvency via uniformity is not achieved. Indeed, the record number of insolvencies around the country also supports this conclusion.

B. IN SPECIALTY LINES, THE DATA AND FORMS OF RATE ADVISORY ORGANIZATIONS ARE NOT CREDIBLE AND NOT HELPFUL TO THE PUBLIC INTEREST OF INSURER SOLVENCY.

The ISO data is least credible in those areas where the "public interest" of insurer solvency is most needed, namely specialty commercial lines. Physicians, day care providers, governmental entities are all areas which have too small a data pool to provide credibility. A good example of this is in the area of dram shop liability insurance.

After the rapid price explosion in late 1984 with regard to dram shop liability insurance, the Minnesota Legislature held approximately a dozen hearings with regard to changes in the dram shop law. Insurance industry witnesses repeatedly testified that Minnesota's law was substantially more expansive than other states, and was the cause for the price explosion. They consistently challenged my comment that the rates were set by the market and that lack of competition in that area had driven the price upward.

Thereafter in August of 1985, I received data from the Maryland Commissioner of Insurance with regard to nationwide experience in dram shop and day care. The data was submitted to him by the ISO office and noted that Minnesota's loss ratio experience for dram shop was approximately 54% over a four year period, which was extremely favorable. It also noted that day care liability insurance had a 17% loss ratio over the same period.

At the next legislative hearing, in which testimony was given that the Minnesota experience was unfavorable, I presented the ISO data given to Maryland and pointed out that it was interesting that the insurance industry would challenge the law in Minnesota when in fact they had given data in Maryland stating that Minnesota was an attractive state with regard to liability issues. The response of the ISO witness after my testimony was that the data was too skimpy from which to give any valid opinion. That being the case, the legislative committee justifiably rejected all of the opinions of the ISO office and indeed the insurance industry in general with regard to liability issues in these areas.

Another example of rate credibility problems is my experience with veterinarians. An analyst advised me that she looked at the filed rate and noted that 42 states had the same rate for veterinarians at $278; four states had a rate of $120; Nebraska had a rate of $213, and New Hampshire had a rate of $80. She wondered why 42 states have higher rate, and I commented that there must be higher pain and suffering claims with the cows in those states.

Thereafter, I wrote a letter to the ISO office asking them to justify this differential, and a Regional Vice President of ISO flew up to respond to the issue. The result of the discussion was an acknowledgement by ISO that the statistics given to it on speciality lines such as veterinarians are not sufficient to achieve any degree of credibility. Accordingly, those states that complained on the rate structure received a lower rate. I was also told that it didn't really make any difference what rate was suggested by ISO because companies would charge below and above it.

Most of these policies are sold by non-ISO members, and the policies in many cases are not filed with the states due to surplus lines laws.

If it makes no difference what data ISO compiles in such areas perhaps it should not be compiling such data at all. If the data compilation is in the public interest, it should be done by the state.

C. IN COMMERCIAL GENERAL LIABILITY (CGL) FILINGS, RATE ORGANIZATION ADVISORY DATA MIGHT BE CREDIBLE. UNFORTUNATELY, THE INDUSTRY DOES NOT FOLLOW IT DURING THE TIME THE PUBLIC INTEREST WOULD BE BEST SERVED BY THE EXEMPTION, NAMELY DURING VOLATILE MARKET SWINGS.

The volatile swings of the insurance market in the 80's were caused by volatile swings in the investment market, and was the principle cause of the record number of insurance insolvencies. The rate advisory organizations had no effect in stabilizing the marketplace and consequently stabilizing insurer solvency. This is because, during periods of market volatility, rate organization data is largely ignored.

Advisory organizations such as ISO have a large number of members in the area of commercial general liability (CGL) insurance coverage. CGL coverage composes approximately 15 to 20% of the insurance market but influences substantially more of the market as many insurance companies wrap around the CGL policy coverage for workers' compensation, fire, commercial automobile, directors and officers, and excess liability. Accordingly, the content of the CGL policy is very important to the average business.

In the Spring of 1985 I called in approximately 85 insurance companies from other states and met with their officers to determine why they were in financial difficulty. Most of these companies ended up with a Cease and Desist Order, Consent Order or stipulation restricting their underwriting ability in Minnesota. This effort, borrowed from the procedures used in bank regulation, was helpful in insulating Minnesota from a substantial number of the insurance insolvencies which occurred during 1986 and 1987.

During one of these meetings, with a rather large commercial insurance company that was in trouble, I asked the executives how they intended to make a turn around. They basically said they increased their rates by up to 50%. I responded that I thought such an increase would result in adverse selection, where the better clientele would leave for other insurance companies and they would be left with high risk clientele. They advised me that the opposite is the case, that the higher the rate the more likely it is that the bad risk will leave the company and that the good risk will remain. They pointed to their experience over the prior four months, comparing the loss ratio of customers which stayed with the company and the loss ratio of customers that had left. Those customers which left the company had a substantially higher loss ratio. They noted that bad risk customers tend to be "shoppers" while good risk customers merely pay the bill. The pricing of the insurance product had no relationship to rate advisory organizations.

In the personal lines area, Economy Fire & Casualty was taken over by Kemper Auto, and sold a considerable number of automobile insurance policies in southern Minnesota. At one point they raised their rate by almost 50%, and many policyholders wrote letters to me complaining that I should not have approved their rate increase. I responded to them that I did not have the authority to approve or reject rate increases, and told them to shop around. They subsequently did and advised me that they obtained cheaper rates elsewhere. The rates were not representative of their driving record, or of their history, and obviously were not representative of any actuarially determined figure. Mutual Service of Minnesota is another company that last year tested the market by rapid increases, and subsequently reduced rates in an effort to retain market share when customers left the fold.

Another example of premiums set other than on an actuarial basis is Great American Insurance Company and its farm umbrella policy. Last Spring they filed for a 50% increase on a farm umbrella policy in Minnesota. An analyst asked for substantiation of the increase, and subsequently received a letter noting that its nationwide loss ratio on the policy was approximately 65% over the previous five years. The analyst responded to the letter by noting that a 65% loss ratio would not justify a 90% increase. The analyst then asked the company to please justify the increase.

The company finally responded that no claim had ever been filed in Minnesota. The rate increase did not have any actuarial substantiation but rather was a rate set by market conditions.

There are also many examples where insurance companies price the product upward on the basis of competition. The best example of this is December of 1984 in the area of liquor liability coverage. There are 5,000 liquor licensees in Minnesota, all of which must have liability coverage in order to obtain their license. In 1984 there were five insurance carriers selling liquor liability insurance. Ideal Mutual, Gibralter, Insurance Corporation of Ireland, Allied Fidelity and Columbia Casualty. During a short period at the end of 1984 three of these carriers went out of the liquor liability insurance business. Gibralter was the object of a corporate merger in which its assets were absorbed by the parent company and the product lines were discontinued; Insurance Corporation of America was enjoined from further sales due to it also being owned by the Bank of Ireland and thus a violation of the Glass-Steagall Act. Ideal Mutual of New York went bankrupt.

Most liquor licensees in Minnesota are required to obtain their annual license on January 1 of each year. In mid-December, with the collapse of Ideal Mutual, liquor licensees had to obtain coverage from the two remaining insurance companies. With the onslaught of demand, the insurance rates increased approximately 300%.

This acceleration took place over a period of less than six weeks. I do not have the exact dates because at that time the commercial policies and rates were not required to be filed with the Department. When I contacted the two agencies selling the coverage and asked them the basis for the increase, one admitted that it was due to market demand.

While insurers tend to ignore rate advisory organizations during market swings, they have been known to close ranks behind such an organiztion when it does not serve the public purpose.

The ISO claims-made CGL policy is an example. In 1985 the ISO announced that it would change its CGL policy from an occurence policy to a claims-made insurance policy. This policy represented a dramatic change in insurance coverage, and would have resulted in many businesses not having coverage which they thought they had at the time of purchase. I won't bore you with the details, but the claims-made CGL policy, either as originally proposed by the ISO office or as approved in most states today, contains many anti-business provisions, particularly as it relates to "tail" coverage, the claims "trigger," the reporting periods for claims history, and a description of the content of the policy. Indeed, I believe the claims-made policy in itself will transfer substantial portions of risk to the unknowing business and, if readily accepted in the market place, will have a tremendous anti-competitive effect in the pricing of commercial insurance.

In January of 1986 I issued an order rejecting the filing of this policy. This was at a time that approximately 35 to 40 other states had already approved the policy, and in many cases after pressure was exerted on those states by insurance companies. Finally, in Spring of 1986, representatives of seven major insurance carriers met with the governor and myself with regard to various insurance issues. During that discussion one of the insurance carriers made it plain that, if the claims-made policy was not approved, it would pull out of the state. To me it was a clear indication that these companies, all in the presence of each other, basically indicated that they would boycott Minnesota if the common form was not adopted. Such tactics have occurred in other states in the areas of malpractice coverage.

Fortunately, the claims-made policy has not received substantial usage in the marketplace.

In contrast, I believe that any insurance carrier could easily have developed a commercial form on its own. Or, in the alternative, a form could have been drafted under state authority and thereafter used in the market place.

Other examples where such leverage has occurred are the exclusions for environmental damage, employee hiring practices on CGL policies, and the inclusion of defense costs within policy limits.

It seems to me that, if uniform forms are to be used, particularly on products that are statutorily mandated for businesses and consumers, the provisions should be drafted by the State or in a competitive fashion.

D. INSURERS HAVE REPEATEDLY ARGUED THAT THE PUBLIC INTEREST IS SERVED BY A COMPETITIVE RATE SYSTEM UNFETTERED BY REGULATION. THE ANTITRUST EXEMPTION IMPLICITLY PERMITS REGULATORY INTERFERENCE -- BY THE INDUSTRY -- IN THE MARKETPLACE.

It is interesting that when states propose rate regulation or "flex rating" the industry argues vociferously that open competition is better for the consumer and the industry. When we recently proposed "flex rating" in Minnesota the industry called in expert after expert to argue that it is inefficient, wasteful and inappropriate to set rates.

If it is not in the public interest for the state to regulate rates, how can it be in the public interest for the carriers themselves, under the guise of an anti-trust exemption, to exchange data upon which to base a target rate.

With regard to forms, I once proposed that a common form be used for homeowners and automobile insurance policies. I did so upon the belief that:

1. Most consumers have never read their insurance contracts, do not know the differences between various contractual provisions, and accordingly would not be able to make an apples to apples comparison on insurance rates.
2. The terms of the insurance contract would better serve the public good if they were developed by the state at a policy making level rather than subject to a rapid technical review.

The insurance industry has repeatedly advised me that such uniformity is inappropriate and indeed robs the market place of creativity. They argue that it is interference with the market place and that they should be able to competitively determine the content of their product. Yet they turn around and collectively draft forms through the use of industry sponsored organizations.

I believe that, if competition is to be the primary regulator of the content of this product, the anti-trust laws should apply. I do not believe that reliance upon common industry drafted provisions is necessary for the stability of an insurance company. If uniformity is a public policy goal, then the state is the appropriate author of forms.

E. THE PUBLIC INTEREST IS NOT PROTECTED UNDER THE FILE AND USE LAWS THAT EXIST IN MOST STATES.

The insurance carriers may argue that the states review the rates and contracts and therefore, the drafting or rating of these policies need not be done by the state. This argument ignores reality. For instance, the insurance department in Minnesota has four life and health insurance analysts and five property and casualty analysts. These people annually review approximately 8,900 automobile forms, 4,500 homeowners forms, 29,000 commercial liability insurance forms, 13,000 life insurance forms, and 7,300 health insurance forms. These filings measure over 500 feet of paper per year. This works out to approximately 55 feet to be reviewed by each analyst per year, or over one foot per week. You can imagine how stimulating it is to read insurance policies. Obviously the analyst does not have an opportunity to review many contracts with sufficient detail to know the content of each provision. Further, companies put different provisions under different headings, which makes it substantially more difficult to determine exactly what is intended by the contract. Even if the analyst were able to find the provision, the public policy ramification of the provision may be interpreted differently by each analyst who is reviewing the provision. The end result is that inconsistent interpretations regarding policy provisions will occur, not only among analysts, but among filings with one analyst, solely due to the volume of filings that are made each day.

Accordingly, no continuity of public policy is achieved through state approval. At best all the state can do is catch a few of the more obvious violators and, through this screening process, hopefully put a "chilling effect" on insurance carriers who would otherwise file the most egregious contract provisions. Thus, state review is not a suitable safeguard to offset the danger of concerted drafting discussions by insurance carriers.

* * *

In conclusion, in light of the fact there are better alternatives to safeguard insurers solvency, and in light of the fact that the exemption has not worked to assure insurer stability, the Antitrust exemption should be repealed. The public perception of the insurance industry is at an all time low. The public perception of the purpose of the antitrust exemption places government regulation at a low. If for no other reason then to instill confidence in the marketplace and the government regulator, the exemption should be repealed.

Senator **Metzenbaum**. Mr. Hatch, I have a few questions. Our new bill would repeal the insurance industry's antitrust exemption without in any way diminishing the authority of the States to regulate insurance.

While I believe the States should regulate insurance, it is no secret that I believe some State insurance regulators are too close to the industry they are supposed to regulate and would do a better job if they were more independent.

I am not alone in that view. In 1979 the GAO found there is "less than an arm's length relationship between the National Association of Insurance Commissioners and the insurance industry." They went on to say, "There is almost no consumer participation, but almost no limit to the extent of industry participation."

The National Association of Insurance Commissioners promised to remedy this imbalance, amending its constitution in the late 1970s to require that due consideration be given to including consumer representatives on its advisory committees.

To see whether the NAIC kept its promises, I recently asked it to give me its advisory committee lists. From that information, it is clear the NAIC has not kept its promise. In 1986, of the 459 members of the NAIC's advisory committees, only three, or six-tenths of one percent, were consumer representives.

It is also clear from my investigation that the NAIC is totally dependent on the industry for the funding and operation of its annual meetings NAIC documents and conversations with NAIC officials confirm that the industry subsidizes 100 percent of the expences of NAIC meetings.

Do you think it is right that the industry which your fellow commissioners are supposed to regulate pays for their annual meetings?

Mr. **Hatch**. Mr. Chairman, there is a book called "The Invisible Bankers" by Tobias, and I think the first page describes an NAIC meeting. With all due respect, I think they are good people, good regulators; they try hard. But it does describe it, I think, as the largest cocktail party in the country.

I do not know if that is accurate, but I do know that one of the problems with the exemption is that the only people who have the data is the insurance industry. So, necessarily, the NAIC, by meeting, must have the industry there to give them the data.

Secondly, you have the inherent problem in all regulation, perhaps more so, I think, in insurance, and that is the revolving door syndrome. I suspect if you took a survey of prior commissioners and where they work, you would find that most either work in an insurance company or in a law firm representing insurance companies.

I think that the combination of the revolving door syndrome, of the fact that the data is held by the industry so it does not do any good to have a meeting if you do not have the data, results in less than an arm's length relationship that one would want to have.

I think the people within the NAIC work hard, they try hard, they do a good job at what they try to do, but there is that inherent conflict.

Senator **Metzenbaum**. Is it not the fact that the NAIC conferences or conventions are very much subvented by the insurance industry, that is, that it is a regular practice for the insurance industry to be called upon to pick up the tab for these meetings?

Mr. HATCH. Mr. Chairman, it would be very difficult—anybody coming from a regulatory agency generally is swamped by lobbyists and other people from the insurance industry at these meetings.

The ratio has got to be five, ten, to one of industry——

Senator METZENBAUM. Five or ten to one of the——

Mr. HATCH. Maybe I am overstating that; five to one of the industry to an individual governmental entity. It is very strong.

Senator METZENBAUM. And realistically speaking, they pick up a very substantial portion of the tab for their entertaining and their activities at the conferences?

Mr. HATCH. I believe so, sure.

Senator METZENBAUM. Let us talk a moment about ISO, the Insurance Services Office, the insurance industry's rate-setting arm. I have been studying how ISO calculates its rates.

While my investigation is not over yet, what I have learned so far leads me to suspect that those rates are arbitrary and excessive. For example, the ISO rates appear to include arbitrary allowances for commissions and expenses. The ISO rates also include an underwriting profit margin which is arrived at without taking into account the billions earned by insurance companies in investment income.

In my own State of Ohio, actuarial studies show that ISO rates, including the factors for expenses, commissions and profits, were greatly excessive. Rather than the 40-percent increase in the 1987 rate for property damage which ISO filed, these studies concluded that the rate actually should have been decreased nearly 20 percent, using accurate cost data.

What is just as disturbing, Mr. Hatch, is the tendency of insurers to follow the ISO rate. In Ohio, for example, eight of the ten largest product liability companies charged the ISO rate in 1985, and right here in the District, homeowners' rates consistently have been within 2 percent to 9 percent of the ISO rate.

As an industry publication put it not too long ago referring to liability insurance, "What has occurred is a return to basic ISO rating subject to a minimum 20-percent surcharge." That was in the National Underwriter of September 6, 1985.

Commissioner Hatch, I am troubled by the whole idea of an organization funded and directed by the industry setting rates, especially where those rates are inflated. It violates the principles of free competition and seems to go way beyond the legitimate needs of individual insurers in jointly gathering hard loss data.

What are your views? Do you think the ISO rates are arbitrary and excessive? What are your comments on that score?

Mr. HATCH. Mr. Chairman, with regard to speciality lines, general liability I would consider to be a speciality line commercial coverage.

Senator METZENBAUM. Could you bring the mike a little closer, please?

Mr. HATCH. Okay. With regard to speciality lines coverage, the ISO office does not, at least according to representatives I have talked to of that office, and I believe it to be true, have credible data to begin with. If you do not have credible data with which to make projections, perhaps you ought not be making the projections at all.

This applies to general liability lines such as veterinarians, day care, liquor liability, governmental entities. We've had lots of data problems with liquor liability insurance in my State. There was a letter sent by the ISO office to the State of Maryland and it has a State-by-State breakdown of these various speciality lines coverage for each State, and I looked at Minnesota.

This was after ten hearings we had had at the Minnesota Legislature talking about liquor liability coverage being solely the fault of Minnesota; that it was okay everywhere else. This was in late 1984 before the crisis became known to be a national issue.

Basically, the thesis of the industry was that if we changed the tort laws on liquor liability in Minnesota, then everything would be fine. And, of course, the problem was that I knew what was going on because I talked to the agents. There were only two companies and they did a 300-percent increase in a week, or about a 3-week period, after Ideal Mutual and some other companies——

Senator METZENBAUM. They both increased 300 percent?

Mr. HATCH. Roughly 300 percent over about a month to six—about a month period in December of 1984, there was about a 300-percent increase. At that point in time, there were basically five insurance carriers in Minnesota selling liquor liability through 1984, Ideal Mutual out of New York, Insurance Corporation of Ireland, Gibraltar Insurance, Allied Fidelity, and Columbia Casualty, those five.

The Insurance Corporation of Ireland was, I think, kicked out of the country, basically, by the fed, because it was also the Bank of Ireland, under Glass-Steagall. Gibraltar was taken over and its assets absorbed into the parent company, so it was no longer in speciality lines. The third one, Ideal Mutual, went under, not because of liquor liability but for many other reasons. It was a fronting company. Then there were two others.

Liquor liability in Minnesota is a mandatory coverage; you have to have it in order to operate. Most of those licenses came up January 1 of the year, so in the 2 weeks of December you had probably 2,000 to 3,000 of these liquor licensees inundating two agencies looking for coverage. They could not possible handle the coverage on their own and, of course, the rates went up as a result.

We had about ten hearings after that, with explanations being given that it was the liquor liability law. At the end of those hearings—in fact, in November of 1985 I got this letter from Maryland and I looked at the Minnesota loss ratio and it is, I believe, 54 percent for the 5 years, which is a favorable loss ratio for liquor liability, 54 percent.

So at the next hearing in November, I go up to the State legislative committee and testify and say, look at this. You know, obviously, this was a competitive issue. It had nothing to do with the liability law. Otherwise, you know, something would have been different.

The next witness up was from ISO and they said, but this data is no good; we do not have enough data to really give you accurate projections on specialty lines such as liquor liability.

Well, he is right, but the point of it is why waste everybody's time in those ten hearings talking about liquor liability laws when, in fact, the issue was competition to begin with?

Senator METZENBAUM. And both of them went up 300 percent?

Mr. HATCH. Roughly 300 percent.

Senator METZENBAUM. And no competition available?

Mr. HATCH. Right.

Senator METZENBAUM. Let me ask you a question. You are an insurance commissioner. How much authority do you have or do other commissioners have with respect to rates, or is it not the fact that in most States of this Union they go to the ISO, they find out what the rate should be or what the ISO suggests as the rate, as one of my questions indicated, they add a 20-percent surcharge onto that, file it, and use it, and the insurance commissioner does not do anything about it? Am I not correct?

Mr. HATCH. Pretty much so, yes.

Senator METZENBAUM. While this hearing does not relate to the subject of the adequacy of State regulation somebody asked me this morning at a press conference before this hearing what is Congress going to do about the alleged failure of State regulators to do what they should be doing.

I pointed out that Congress cannot do anything about that; that that is a responsibility of the States themselves. But it is a fact throughout the country, as I understand it, that insurance commissioners, no matter how well-intentioned they are, by reason of their own State laws in many instances or by reason of past practices, are really not in much of a position to require an insurance company to force them to lower their rate? Were you in a position to do so in this instance?

Mr. HATCH. Mr. Chairman, no. Indeed, what is so ironic is it got so tight, what was the solution? Do I kick them out of the State so there was no insurance available? They had a lock on it.

What we did do in Minnesota is we set up a joint underwriting association to make the insurance available through the State, but it said specifically in the statute that the rate had to be higher than the market, the market being those two companies, the end result being, of course, is that what it did do is put a cap on the rate increase.

Senator METZENBAUM. Why did it have to be higher than the market?

Mr. HATCH. Because that is the way the statute was enacted.

Senator METZENBAUM. The lobbyists seem to be a little stronger than you with the legislature.

Mr. HATCH. Mr. Chairman, I regulate banks, securities firms, and insurance companies, and it is interesting watching how they work. In insurance, there are probably 65 lobbyists and they vote like the Kremlin; it is all one way. [Laughter.]

When it comes to banking, the nice thing is you have got the independent bankers and you have got the Minnesota bankers and you have got the big banks and the small banks and the regional banks, and they fight amongst each other and it kind of shakes it up. The securities industry is fairly competitive as well.

But it is difficult when you are dealing with the insurance industry. There is a very strong lobby, extremely strong.

Senator **Metzenbaum**. Mr. Hatch and Mr. Swain, I will turn it over to Senator Thurmond who may have some questions of you.

Senator **Thurmond**. Thank you, Mr. Chairman.

Mr. Hatch, you are the State insurance commissioner of Minnesota?

Mr. **Hatch**. Correct.

Senator **Thurmond**. Do you favor turning over regulation of insurance to the Federal Government?

Mr. **Hatch**. Mr. Chairman and Senator Thurmond, I am in favor of Federal solvency regulation. I am not in favor of the police powers——

Senator **Thurmond**. Speak louder; I cannot hear you.

Mr. **Hatch**. What?

Senator **Metzenbaum**. Pull the mike closer.

Mr. **Hatch**. Oh, okay.

Senator Thurmond, I am in favor of Federal solvency regulation, but that is a separate issue than this one; it is an entirely separate issue. I am in favor of the traditional police powers being kept at the State level, the consumer issues, the policy forms, things like that.

Senator **Thurmond**. Are you handicapped in doing your job for the people of Minnesota as State insurance commissioner?

Mr. **Hatch**. Mr. Chairman and Senator Thurmond, I think insurance regulation could be better, correct.

Senator **Thurmond**. You are well trained, are you not, and you have served in that position for some time?

Mr. **Hatch**. Senator Thurmond, I hope so. I do not know if the insurance industry thinks so.

Senator **Thurmond**. Well, in other words, do the insurance laws in Minnesota need changing or do they need a new insurance commissioner, or do you favor turning the whole thing over to the Federal Government?

Mr. **Hatch**. Mr. Chairman and Senator Thurmond, I am not in favor of turning it all over to the Federal Government. I am in favor of those places where it would be more efficient—namely, insurance solvency issues, which is an entirely separate issue than what we are looking at today—being done on a national, uniform basis. I can go into that if you want; it would take a minute or two.

But with regard to traditional forms and the police power issues, I am in favor of States' rights in that area. It is much like securities laws. I am in favor of blue sky laws at the State level.

Senator **Thurmond**. Do you feel that your fellow insurance commissioners in the various States are not doing a good job?

Mr. **Hatch**. Well, Senator Thurmond, I believe that they do the best job with what they get, but I do not think that that is necessarily, given the circumstances, the best way.

Senator **Thurmond**. Well, what do they need to do a good job? Do they need more State laws? Is that up to each State?

Mr. **Hatch**. Senator Thurmond, I do think if they had the data to work with—and I think in this area we are dealing with an exemption where the only people who have got the data is the industry itself. So the only way that the regulators can get the data is to go to the industry to say will you please give it to me, and you do not know whether it is accurate or not.

Ironically, the very bill that is being offered here—I read it yesterday, I believe—is already in effect in Minnesota. Even in those places, for instance, in workers' compensation with regard to a central rating bureau, we already do this. We already say you cannot include the pricing data; you only include the loss data. There is no problem.

I think the fundamental issue here is a loss of confidence. There is a tremendous loss of confidence in the insurance industry right now, and there is a tremendous loss of confidence in government and its ability to regulate this industry right now.

There is a lot of cynicism out there. I think you saw it this morning with some of the people who were talking, and I see it every day in the letters that are written. People are very, very upset, and they focus on the fact that they get this feeling that this antitrust law, this exemption, the McCarran-Ferguson Act, is a situation where people are going back to the old cartel days. They get on the railroad car, have a cigar, and set the rates.

I do not believe that that occurs, and I am not here to attack the ISO office directly or indirectly, for that matter. But the point of it is where you have got a huge public cynicism with regard to an industry and with regard to the government's ability to do anything about it, and it is all focused on an antitrust exemption that is not necessary for the system to operate, then get rid of it.

Have them compete like everybody else. It will work, it will work well, and you will restore some confidence in the system.

Senator THURMOND. Well, I am construing what you say as you do not have the authority to do what you think you ought to do and you do not have the laws in Minnesota, maybe, to give you that authority.

Have you requested the legislature of Minnesota to give you more authority?

Mr. HATCH. Mr. Chairman and Senator Thurmond, yes.

Senator THURMOND. Have they refused to do it, or they have done it and it does not work?

Mr. HATCH. Mr. Chairman and Senator Thurmond, they have. The difficulty you have right now is the ability to get the information on the data with regard to rate regulation.

Remember what I mentioned earlier. If you pile all of the insurance form filings that occur in our office each year, it is over 500 feet tall. Each analyst is charged with reading at least a foot of those insurance policies each week, and they change the policies around continually.

The staffing of it at the State level—and Minnesota—you know, we certainly are similar to other States in terms of our staffing. It is extremely difficult to expect the analysts to be reading constantly that volume of information. That is just the policies.

And then being able to have the time to go back and take a look at the rate data is impossible in that current mode. And the end result right now is that the various departments end up relying on the ISO offices or the insurance industry itself for the data and I do not think that is a healthy way to go, especially after my experience with the claims-made policy.

Senator THURMOND. I am just trying to get the facts.

Mr. HATCH. Okay.

Senator **Thurmond**. Now, you feel, then, that you are unable to accomplish the goal that you should with the present situation? Answer that so I can hear you.

Mr. **Hatch**. Mr. Chairman and Senator Thurmond, if the issue or the goal is public confidence in an industry, which I think ought to be there, yes, I think——

Senator **Thurmond**. No. The issue is protecting the people. That is the issue, protecting the people, and I am in favor of doing that. I am trying to find out from you if you have the authority to do what you need to protect them or can Minnesota pass laws to protect them, and is that adequate.

Mr. **Hatch**. Mr. Chairman and Senator Thurmond, the answer would be with the antitrust exemption—the answer with regard to this issue of the antitrust exemption is that it does impede the public interest and it does impede my ability to regulate with regard to insurance, the classic example being when companies give the inference, statements, one made right in the governor's office that if they do not get the policy approved, they pull out.

If I recall, one State—I think it was West Virginia, or what not—they basically got the whole legislature to meet and throw out all the laws.

Senator **Thurmond**. Mr. Hatch, you are not answering my question. Answer, please, the direct question.

Mr. **Hatch**. All right.

Senator **Thurmond**. Do you have the authority to do what you need to do to protect the people of Minnesota? It is your job to protect them.

Mr. **Hatch**. Not as much as I would like. Let us put it that way.

Senator **Thurmond**. Have you requested the legislature of Minnesota to give you such authority to protect them?

Mr. **Hatch**. Senator Thurmond, I have.

Senator **Thurmond**. Have they refused to pass laws?

Mr. **Hatch**. No. They have been very good.

Senator **Thurmond**. Or do they not have authority to pass laws that would protect them?

Mr. **Hatch**. Mr. Chairman and Senator Thurmond, they have enacted legislation which I have requested on many occasions. However, I do not believe that regardless of what you do at that level you are going to be able to do something about the fact of seven companies basically saying we are not going to sell if you do not do certain things. That makes it pretty difficult.

What laws do you pass to address that other than a repeal of some antitrust laws?

Senator **Thurmond**. Well, are you taking the position that you do not have the authority and the State of Minnesota does not have the authority to pass laws that you need, and therefore you need some Federal regulation? Is that the position you are taking?

Mr. **Hatch**. Mr. Chairman and Senator Thurmond, I do not mean to be ornery about this, but I do not believe that a repeal of an antitrust exemption is regulation; I believe it is competition. That is what I am saying I am supporting.

Senator **Thurmond**. I am trying to get from you if you have got the authority, as you see it, to protect the people in Minnesota, and if you do not have it, have you requested the legislature of Minnesota to give it to you, and would they have the authority to do what ought to be done or do you have to come to the Congress to get something else done.

Mr. HATCH. Mr. Chairman and Senator Thurmond, I believe with regard to the examples set forth in the statement and with regard to a situation where either a policy is approved or they will not sell—when you get into a situation of an economic boycott, I believe that the Minnesota Legislature cannot address that issue because if they do not sell, they do not sell. It is a very difficult situation.

Senator THURMOND. So construing what you said, and tell me if I am wrong, you do not have the authority to do what you feel you ought to do. The legislature of Minnesota does not have the authority to do what you think you ought to do, and therefore Congress ought to act in this field. Is that in brief—I mean, I am just trying to get your view.

Mr. HATCH. On antitrust laws, yes.

Senator THURMOND. Thank you. It took a long time to get it out, but I found out. [Laughter.]

Mr. Swain, how would repeal of only the antitrust immunity provision of the McCarran-Ferguson Act affect the authority and role of the State insurance regulators?

Mr. SWAIN. Your question is how would the repeal affect the power and authority of State insurance regulators. Presumably, as you know, Senator, and as the committee knows, there is an antitrust doctrine that says that certain concerted activities are allowed when they are required by State action.

So, therefore, the repeal of the antitrust immunity would subject the entire insurance industry to Federal antitrust laws, with the exception of whatever specific exemptions might be carved out in the legislation.

Therefore, it would fall to an insurance company if it were seeking to insulate certain behavior to make sure that that behavior was somehow required by State action. So I think the temptation in many cases would be for insurance carriers to urge more active regulation on a State basis because more active regulation would raise the specter that, look, we are regulated at the State level and therefore you cannot prosecute us under the Federal laws.

But I have no particular expertise as to the line of questioning of Mr. Hatch as to the relationship between the State laws and the Federal laws. I would like to say, if you would allow me, Senator, that Mr. Hatch's example of the dram shop issue is interesting.

This committee and this Congress has in the past several years lifted antitrust exemption for the transportation industry in the airline business and in the trucking business, and part of the phenomenon in those businesses is not only lifting the antitrust exemption, but creating a situation in which you encourage new companies to enter the field.

Now, I do not think lifting the antitrust exemption is going to do anything to encourage new companies to enter the field of writing dram shop insurance. I think that what will encourage companies to enter into the new area of writing dram shop coverage is tort reform at the Minnesota State level of whatever the particular statutes or judicial decisions are that the carriers find so unpredictable that they do not want to get into the business of writing coverage now for future losses in that particular field.

That is why our position is that although we see no policy reason to keep this antitrust exemption as we have it today, that that is really not the heart of the problem as far as the insurance liability crisis is concerned.

Senator THURMOND. Years ago, the Supreme Court went into the field of insurance. The Congress passed a law and immediately took it out, so the States now regulate insurance. You have not advocated that that be changed, have you?

Mr. SWAIN. Absolutely not, and I say in my statement that we specifically do not favor any Federal regulation of insurance whatsoever.

Senator THURMOND. Thank you, Mr. Chairman. That is all. Thank you very much.

Senator METZENBAUM. Well, I gather you both support that part of my bill, which specifically provides that the States retain the right to regulate the insurance industry. Is that correct, Mr. Hatch?

Mr. HATCH. Correct.

Senator METZENBAUM. Is that correct, Mr. Swain?

Mr. SWAIN. Yes, sir.

Senator METZENBAUM. So we have no question about the fact that nobody is advocating Federal regulation, and I want to put that canard to rest.

Taking your point, Mr. Hatch, let's suppose the legislature gave you as much law as you wanted, over the objection of the 65 insurance company lobbyists that work the legislature, and that you could get it through. Even if they gave you that additional authority so you could get into the rate question, that still would not mean that you could get the rate data from the insurance companies if they did not want to provide it to you. Is that correct?

Mr. HATCH. Mr. Chairman, correct, or if they did not have it. The rate organizations may not well have it, certainly, in the speciality lines area.

Senator METZENBAUM. And the second point is that if you had all of that authority, and assuming that they gave you the information you wanted, which is not necessarily the fact and actually is sort of contrary to the fact—but even if you did, that would still have no impact at all upon the insurance company who just said, well, if you do not approve our filings, if you do not approve our forms, if you do not approve our rates, we are going to take our business elsewhere and just walk away from you and there would be no redress at all to that. Is that not the case?

Mr. HATCH. Mr. Chairman, correct, which is fine if it is an individual carrier. What I get bothered about is when a bunch of them do it at once. That is the essence.

Senator METZENBAUM. Which occurred in West Virginia?

Mr. HATCH. Correct, and Minnesota, and I am sure in every State with the claims-made policy. They may not have all walked in on the same day, but we all got the message real clear.

Senator METZENBAUM. They told you that if you did not approve the claims-made policies that they would take their business elsewhere?

Mr. **Hatch**. Or, Mr. Chairman, another way of putting it is this is the only policy we are going to be selling and if you do not approve it, we do not have anything else to sell. I mean, they can do it in a very indirect way.

Senator **Metzenbaum**. Fine.

I am very happy to see that Senator Grassley has joined us here this morning. Senator Grassley, do you have any questions?

Senator **Grassley**. Yes. Thank you, Mr. Chairman. I think most of my questions are of Mr. Swain, but I would not object if Mr. Hatch wants to venture any responses as well.

I am referring to your position as spokesman for small business within the administration. Using the SBA's own size standards, about how many insurance firms, including independent agencies, could be called small?

Mr. **Swain**. Well, I do not have exact numbers for you this morning.

Senator **Grassley**. Well, just generalize.

Mr. **Swain**. I think that my understanding of the industry is that there are perhaps 3,500 firms in the industry, and maybe one-third of those are very locally-oriented, almost to the extent of selling coverage within a county or a two-county area.

So, certainly, many of the number of companies in the industry would be considered small, but I would expect that the majority of the policies written in the United States are from large companies.

But there are a lot of small insurance companies out there that are selling speciality lines or local commercial and property insurance.

Senator **Grassley**. Would you say that there is a relative ease of entry into the business of insurance? In other words, these smaller firms that you referred to that would be a majority of the insurance companies—are these smaller firms actively competing for business?

Mr. **Swain**. Well, the ease of entry, I suspect, has a lot to do with the State regulation, particularly the State solvency regulation. So I suppose that depending on a State-by-State basis, legally it is perhaps easy to enter the business.

The problem is if I have a lot of money to pull together and pool in reserves in order to get enough money to pass the State requirements for selling insurance in a particular State, is it a business that I want to get into and that I want to spend my money on or do I want to go develop real estate or do something else?

That is the question that I think is the troublesome one because if I had a lot of money, I do not think I would go into the insurance business right now, basically because of the tort issues more than the regulatory issues.

Senator **Grassley**. But is there a relative ease of getting into the insurance business?

Mr. **Swain**. In a practical, legal sense, I think so, although Mr. Hatch is more informed on that.

Senator **Grassley**. Yes, Mr. Hatch.

Mr. **Hatch**. Mr. Chairman and Senator Grassley, of the industries that we regulate in our department, I think insurance would probably be the most difficult, not only financially, because you are talking about probably about $2 million in cash. We are not talking about buildings and things; we are talking about real money.

Secondly, they have to have experience within the industry. They have to show that they have got an actuary, or at least the ability to get actuarial assistance; that they have got somebody who is good in finance and investment, somebody who is good in claims. The only place you are going to get that experience is from the industry itself.

If it is a holding company and if they went out and borrowed money, we look at the holding company, make a determination as to whether the debt is such that the holding company will drain or bleed the insurance company. It is tough; it is a tough area to break into, of all of them.

It is much easier to get into banking or to securities firms, things like that, and other areas of finance than it is to get into insurance.

Senator **Grassley**. Mr. Swain, in formulating your opinion here today, have you consulted with or otherwise heard from small insurance firms?

Mr. **Swain**. Small insurance firms?

Senator **Grassley**. Yes.

Mr. **Swain**. We have heard from a lot of agents of a handful of small insurance firms, but I cannot say that we have heard from very many, Senator.

Senator **Grassley**. Do they share your views on the McCarran-Ferguson immunity?

Mr. **Swain**. I suspect that there is a wide variety of opinion within the small insurance business.

Senator **Grassley**. As a Federal advocate for small business, do you have any fear of what might happen to the smaller insurance firms of McCarran-Ferguson is changed or repealed?

Mr. **Swain**. Yes, sir. That is why we have a section of our statement which specifically focuses on the importance of very carefully writing certain exemptions from antitrust immunity, or certain exemptions that would confer antitrust immunity on certain activities, and I suspect that my list of activities would be considerably broader than Mr. Hatch's list, and indeed at this point it appears to be broader than what Senator Metzenbaum has in his even recent bill.

For instance, we feel the need to insulate to a degree the pure premium process in which a central actuary can share information not only on loss rates but on basic pricing schedules, absent administrative and other overhead costs, and I do not believe that is allowed for in Senator Metzenbaum's bill.

Senator **Grassley**. Does your concern come from a fear of concentration in the industry towards the larger, more powerful firms if there is a repeal?

Mr. **Swain**. Oh, I do not think it is that theoretical. I think my concern is just for a small firm being able to do business on a day-to-day business in a reasonably uncomplicated way, getting the information they need to get in order to write coverage.

I am not saying that the concentration issue is not an important one to look at, but, frankly, we would be more interested at this point in small firms telling us how their actual business practices would differ on a day-to-day basis because of a proposed change in the law.

Senator **Grassley**. I hope you would say that it is fair to say that all businesses, and particularly smaller businesses, have a real desire to avoid litigation, be it with the Federal Government, State government or private parties, right?

Mr. **Swain**. Yes, sir.

Senator **Grassley**. And, of course, they want to avoid it like a plague, right?

Mr. **Swain**. I certainly think so, yes.

Senator **Grassley**. Okay. Why is that?

Mr. **Swain**. Because it is costly in terms of money and in terms of time, obviously.

Senator **Grassley**. And that concern over litigation is real whether the suit is justified or not, is it not?

Mr. **Swain**. Well, it is particularly real if the suit is not justified.

Senator **Grassley**. And are you not concerned about applying a statute as litigation-prone as the Sherman Act, with its treble damages and attorney fees, to the practices of an industry that has been immune for so long?

Mr. **Swain**. To be honest, Senator, not particularly.

Senator **Grassley**. Not particularly, even considering how costly?

Mr. **Swain**. Well, every major industry in this country, or most major industries in this country have to live under the Sherman Act. When we had the Sherman Act, in effect, applied to the trucking industry a few years ago when we eliminated antitrust immunity for trucking rates, we saw small trucking companies flourish.

Now, admittedly, the trucking industry is a lot simpler industry than the insurance industry.

Senator **Grassley**. So you are predicting we are going to have a growth of small insurance companies?

Mr. **Swain**. I am not predicting that whatsoever, but I am not about to predict that we are going to have terrible things happening to small insurance companies if this sort of review takes place.

Senator **Grassley**. Do you think that the mere change in the 40-year history of this Act will have untoward effects on the propensity of people to sue, rightly or wrongly?

Mr. **Swain**. I do not think it will have anything to do with the propensity of people to sue under various tort causes of action. That is why we strongly encourage the Congress and State legislatures to do something on tort reform.

Senator **Grassley**. Okay. Well, I have got some interest in whether or not we are encouraging suits to a greater extent than before because it seems to me like, you know, I do not know any corporations that pay these costs of doing business. They are passed on to policyholders.

Do you not think that policyholders are going to pay the increased cost of the insurance industry's increased litigation over these concepts of a dramatic change in the antitrust laws?

Mr. **Swain**. Well, I guess I am not sure that I would agree with your premise as to how much there are going to be increased costs and increased litigation because of repeal of the antitrust law.

I think that that certainly is an unknown. There is certainly a possibility there can be some more, but it is not clear whether there is going to be a lot more or whether the insurance industry is able to act like most other industries can normally without collusion and normally without being sued. I think there is a strong likelihood that there will be some suits, but I am not sure that I can sit here and say there will be a lot of litigation.

Senator **Grassley**. Mr. Chairman, I will ask further questions in writing so I do not take any more time.

Senator **Metzenbaum**. Thank you very much, and thank you, Mr. Hatch and Mr. Swain. I might say to my distinguished colleague from Iowa that if you are going to provide an exemption to an industry because they might be subject to suit, then I suppose we ought to exempt the auto industry, the textile industry, the steel industry.

In fact, we ought to repeal the antitrust laws of this country, which I know you would not advocate. But all other major industries can operate under the law.

Senator **Grassley**. Mr. Chairman, as a matter of philosophy, I cannot disagree with that, but we are talking about replacing a 69-word piece of legislation that has been in existence for 40 years the way it is now, with some original intent going back even before that, with the six-page bill that you have now introduced, and I think we need to know exactly what we are doing.

Senator **Metzenbaum**. Well, the reason we have a six-page bill, if I may say to my distinguished colleague, was to be certain that we took care of the concerns of people such as Senator Thurmond, who wants to be absolutely certain that there is continued State regulation.

I did not know of any way to put that without writing it in the English language, and I did not know any way to protect some of the joint activities of the insurance industry without writing it in the English language.

But if my colleague is inclined to come on board if I can shorten the number of words, you have got me. I will join with you. [Laughter.]

You just write the words and it would be fine with me.

Senator **Grassley**. I doubt if I have ever made a legislative decision based just on the number of words in a piece of legislation.

Senator **Metzenbaum**. Well, I thought that was what you were suggesting, that it was a six-page bill.

Senator **Grassley**. No.

Senator **Metzenbaum**. We will make it a four-page bill if it brings you on board, my good friend.

Our next witnesses are Josephine Biasiotta, an Ohio medigap insurance consumer, and Nellie Smart, also an Ohio medigap insurance consumer. Both are from my own home community of Cleveland.

We are very happy to welcome you, Ms. Biasiotta and Ms. Smart. Ms. Biasiotta, we are happy to hear from you. You know we have a 5-minute rule.

STATEMENT OF A PANEL CONSISTING OF JOSEPHINE BIASIOTTA, OHIO MEDIGAP INSURANCE CONSUMER, CLEVELAND, OH; AND NELLIE SMART, OHIO MEDIGAP INSURANCE CONSUMER, CLEVELAND, OH

Ms. **Biasiotta.** Right, I understand. I thank you for having me here.

Ladies and gentlemen, good morning to everyone. My name is Josephine Biasiotta. I am here today on behalf of this false representation on television. It is really getting to the point where a lot of these elderly folks are sitting at home watching TV and along comes this beautiful colored commercial. You have to buy this insurance; this is just what you need. It is going to cover up all your aches and pains and it is going to pay up all your bills.

I had occasion to investigate on my own to find out if this was really true, so I did contact two insurance people. They came to my home and I explained, I want information before I drop my policy to see what you are going to give me. I wanted to compare one way and the other, and I found out it was not true.

I would be paying more on their policy, according to my age, and I would be getting less coverage. The premiums that I pay now to Medicare and Blue Cross and Blue Shield of Cleveland, plus a little medi-fill from Blue Cross, cover up a majority of the bill.

What they think is a fair price, they will pay, Medicare, the 80 percent, and a fair price of what Blue Shield thinks will take up the 20 percent. What is left, I am still paying out of my pocket.

But I bought this small medigap—here, you call it medigap; in Cleveland we call it medi-fill—to take up the slack that both insurances have left behind. Still, it does not cover it all because I have taken the low option. Financially, that was my limit.

Now, these insurance people tell me in the beginning they are going to cover 100 percent here; it is going to cover this, it is going to give you good coverage. If my husband should be put in a nursing home, because he is a very handicapped person—and I had to leave him to be here today because I have reasons—telling me that they would cover quite a bit of this nursing home business.

My daughter is an LPN at a nursing home, so I get more information, and it is not so. What I am saying here today is cannot something be done about this false representation on television, bamboozling the elderly people that are sick and having to keep the TV on. Why must they represent that they are going to cover the world for these people and then you find out it is not so?

Now, when these gentlemen came to my home to give me this information, I requested I just want information to compare before I drop what I have and pick you up. Well, the outcome of this was, for you, Ms. Biasiotta, as soon as you sign that paper you will be taken care of immediately. Your husband, you will have to pay for 6 months before you get any coverage because he is a sick man.

Now, you are telling me I would be paying $84 a month and I would be covered. For 6 months, I am paying for my husband $84 and not getting any coverage, and he needs coverage.

When I compare that price to what I am already paying, I am paying more with their insurance company and getting less, and I am paying less and getting more for what I already have.

Now, anyone else watching that commercial would think, hey, I have got it made if I buy this insurance; I am going to do it. But I had sense enough not to do it, and do you know that company never came back at me to find out why did you not call me back, why do you not buy this insurance, because I definitely stated I will not sign anything, I will not say another word until my children have read these papers.

So if he was a true salesman—and he was a high-pressure one. For over an hour he sat there and talked to me. Medicare does not do this, we do this, and the whole rigmarole, and the end of this was not a word was true.

Senator **Metzenbaum**. And the medigap insurance was $84 a month. You were to pay it for 6 months before you would get any coverage at all?

Ms. **Biasiotta**. This insurance company, yes. They would cover some of the hospital, some of the doctors, and some of this and some of that, and it was not so.

Senator **Metzenbaum**. I have some questions for you, but I think first we will hear from Ms. Smart.

We are happy to have you with us, Ms. Smart. Tell us your name and—Ms. Biasiotta, did you tell us your name in the record?

Ms. **Biasiotta**. I believe I did; Josephine Biasiotta from Cleveland, Ohio.

Senator **Metzenbaum**. Okay.

Ms. Smart?

Ms. **Smart**. Nellie Smart from Cleveland, Ohio.

Senator **Metzenbaum**. Would you bring the microphone closer to you, please? Please proceed. We are happy to have you with us.

Ms. **Smart**. Nellie Smart from Cleveland, Ohio.

Senator **Metzenbaum**. Please proceed and tell us your story.

Ms. **Smart**. My story is about bills that Medicare and Blue Cross are supposed to pay, and the difference in the case of what she has experienced—I started out to do the same thing that she had refused to do, and that was to take another insurance, and I too would have had to wait for a length of time before the insurance.

But I listened and watched television one night and then I got the idea that I would not go through with it. So I dropped that part, but I still have to pay Medicare and Blue Cross, and Medicare and Blue Cross do not pay the bills that the doctors charge you now when you go in the hospital.

The different number of cases in the hard-pressed era that we are in as senior citizens to pay the doctor and buy the prescription drugs is not just exactly as it seems, even with the insurance that we have, nor Medicare, nor Blue Cross. This is why I am here asking to testify, to see if there is something that insurance companies could give us better with.

My husband had eye surgery for one eye cataract. I had to take him in. He had to be there at 7 o'clock in the morning. About 1:30 or a little after, he was ready to go back home. I had to be the nurse to put the drops in his eyes, see that he kept his head in a certain position, help him to get his clothes on and to redress for the next morning, and take him back, be there by 8 o'clock in the morning after they dressed the eye and sent him back.

Of all the money that Medicare and Blue Cross have paid to the doctors, we are still being billed, and we get so many bills until there is so much pressure until sometimes I feel like just giving up everything.

The insurance companies pay exactly what they want to. I received one bill that was $30 just for myself. That time, the bill itself—they gave me $5.80 on a $30 bill, and that is nothing. The balance was for me.

Senator METZENBAUM. No explanation?

Ms. SMART. No explanation. I have some here that I want to leave with you all today. You can go through them and see what I am talking about, and in that way you will be more able to understand what senior citizens are going through.

My husband is home. He is 91 years old and every once in a while he has a flare-up with emphysema and other diseases that are deteriorating his body. I have a heart condition. When I have a prescription filled, plus when he has to have medicine—and this is constant with me. I have two drugs that I must have every day of my life.

Until here recently when I changed medical facilities, I was paying $51-and-something every month out of a $389 check for just medicine alone. I pay Blue Cross now $147.78. I pay AARP $98.50 for my husband, so that leaves nothing for us hardly to survive on because by the time we buy medicine and pay Blue Cross, Medicare, gas, lights, telephone, which is a necessity, and buy a little food, we just exist. We do not live; we exist.

Senator METZENBAUM. Tell me, Ms. Smart, did you work in your lifetime?

Ms. SMART. Yes. I worked since I was 9 years old going on ten. I started working for 50 cents a week and I worked until I was 66 years old, and the last year I worked I made $4,040 for the first time in my life.

I had a late husband that took sick and had a brain hemorrhage in 1946 and I had to support him. I never received any help except what a hospital gave to me for the job that I was working on when I was working making $12 a week when he took ill, and that lasted for a period. I had taken care of an old mother and then I remarried in 1972 and now this husband is sick.

Senator METZENBAUM. Have your medigap policies made you feel more secure about being able to pay your medical bills?

Ms. SMART. Did they do what?

Senator METZENBAUM. The fact that you have medigap insurance, does that make you feel more secure that you are going to be able to pay your——

Ms. SMART. I do not feel secure anymore.

Senator METZENBAUM. And the medigap policy, your testimony indicates, has not paid all of the expenses that they said they would pay for you, is that correct?

Ms. SMART. If they paid all that they should have paid to me, it is still not enough to cover what doctors charge you. Even the doctors that say that they will accept Medicare, whatever Medicare or your insurance will pay, you still get bills.

That is the reason I brought them along so you could see, because on there it says your doctor has accepted what Medicare and what Blue Cross pay, and every day or two the mailbox is full of mail for bills from that same doctor.

Senator METZENBAUM. Do you feel you were misled when you bought the medigap insurance?

Ms. SMART. Yes.

Senator METZENBAUM. You each talked about slick TV ads and high-pressure sales tactics associated with medigap policies. Ms. Biasiotta, do not these ads and high-pressure tactics play on the fears and anxieties of older Americans such as yourself?

Ms. BIASIOTTA. Yes, they do. They play quite a bit, especially in my home because, as I said, my husband has to have medication the rest of his life. That alone costs me $150 a month, because he has Parkinson's, he is diabetic, he has had several strokes.

He was legally blind in one eye until the surgery gave him a tiny bit of vision in there, an implant in both eyes. So he has to have these drops in his eyes every day, plus the diabetic medicine.

I am not complaining. I am accepting what the Lord has sent, but when the poor man sits and watches TV, especially the beautiful colored pictures, they are playing golf and they are advertising this insurance and you will have no worries left, I was often asked in the last several months, why do we not get that insurance and we would not have to worry?

This is what made me want to contact the insurance companies to find out if they were selling the right thing on TV to people that sit there and have no choice but to watch until the next picture comes on.

Senator METZENBAUM. Well, Ms. Biasiotta, do you not feel real good that we have provided so much employment for all of yesteryear's movie actors? [Laughter.]

Ms. BIASIOTTA. Sometimes I say the commercials are more enticing than the movies themselves. [Laughter.]

But if you could distinguish between right and wrong, you have no problem. But I am feeling sorry for hundreds of people in my area that every day ask me, well, you are up front fighting for us all the time. What are you going to do about this commercial? It is getting to me now, so I am here today for this reason because it is not so.

Senator METZENBAUM. Thank you.

Ms. BIASIOTTA. Unlike Nellie, I had never occasion to go to work because my husband was in self-employed shoe repair. I raised a family with that little shop, which turned out to be a mom-and-pop shoe repair. I was not getting paid.

I would go in a few hours a day in the business, clean up the shop, wait on customers. So today I do not have an income of my own. It is just a percentage of what I would get from my husband.

It totals down that after I have paid everything that has to be paid, for the rest of the month I only have $422 to live on. I am still in my own home. I have to pay my real estate taxes. My water and sewer bills are going sky-high, Mr. Metzenbaum. You know how that is in Cleveland. I do not have to tell you that part.

You want to live with a little dignity. You have to have a phone because you have a sick person. To me, it is not a luxury anymore; it is a necessity. But what I am complaining about, please, do something about this false advertising.

When they tell you, for instance, you can buy this kind of pill and it is going to do wonders for you—you buy this kind of pill and hair is going to grow on your head again. I just cannot see why people—you pay for that TV, you pay for the electricity and you have to listen to all that garbage.

Senator **Metzenbaum**. Thank you very much.

Senator Thurmond, any questions?

Senator **Thurmond**. Thank you, Mr. Chairman. I have no questions. I want to thank you both for your presence here.

Ms. **Biasiotta**. Thank you for having me here and listening to me, and I thank all my audience for listening.

Senator **Metzenbaum**. Excellent testimony. Thank you so much.

Ms. **Smart**. Thank you.

Senator **Metzenbaum**. Our third panel is Mr. James Matschulat, Regional Director of the Alliance of American Insurers and President of the Middlesex Mutual Assurance Company of Middleton, Ohio; Mr. James Osborne, Chairman of the National Association of Mutual Insurance Companies and Chairman and Chief Executive Officer of ~~the Oreg~~on Mutual Insurance Company of McMinnville, Oregon; Mr. Michael Mullen, of counsel to Crowell and Moring, Washington, D.C.; and T. Lawrence Jones, counsel, Hunton and Williams, of Washington, D.C.

We are happy to have each of you with us this morning, gentlemen. I think you know our rules about a 5-minute limit. Mr. Matschulat, you are accompanied by able counsel, the father of a beautiful little girl.

Mr. **Matschulat**. Yes. We have been comparing notes about my 13-month-old son and Steve Cannon's 21-month-old daughter.

Senator **Metzenbaum**. Well, he is known well to us, as you know, from having worked with this committee. We are happy to welcome you. We have a 5-minute time limit. Please proceed.

STATEMENT OF A PANEL CONSISTING OF JAMES O. MATSCHULAT, REGIONAL DIRECTOR, ALLIANCE OF AMERICAN INSURERS, AND CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, MIDDLESEX MUTUAL ASSURANCE CO., MIDDLETOWN, CT; JAMES L. OSBORNE, CHAIRMAN, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES, AND CHAIRMAN AND CHIEF EXECUTIVE OFFICER, OREGON MUTUAL INSURANCE CO., McMINNVILLE, OR; T. LAWRENCE JONES, HUNTON AND WILLIAMS, WASHINGTON, DC; AND MICHAEL J. MULLEN, CROWELL AND MORING, WASHINGTON, DC

Mr. **Matschulat**. Thank you. I would like to begin. Middlesex Mutual is not a buckeye company, but rather a nutmegger. We are from Middleton, Connecticut. I would like to also comment on an earlier misconception, or at least as I understood it, a misconception by Commissioner Hatch.

The kinds of activities that he is referring to in terms of the claims-made policy, it seems to me, are collusive activities which are prohibited as a boycott under the current statutes. So I fail to understand the problem.

Senator **Metzenbaum**. Pull the mike closer, please, Mr. Matschulat.

Mr. **Matschulat**. Sorry.

Certainly, there are, as we heard from the previous witnesses, a lot of important problems in the world. I have yet to hear any that would be in any way helped by a modification or repeal of the McCarran-Ferguson Act. It strikes me that bill S. 1299 is a solution in search of a problem.

Good morning. My name is James O. Matschulat. I am chairman, President and Chief Executive Officer of the Middlesex Mutual Assurance Company of Middleton, Connecticut. I am accompanied this morning by Steve Cannon of the law firm of Wonder and Diefendorfer. I am here today on behalf of the Alliance of American Insurers.

Our more than 175 member companies include such well-known insurers as Liberty Mutual, Kemper, and Prudential Property and Casualty. They also include hundreds of smaller companies like my own.

The insurance needs of millions of America's homes and businesses are the concerns of these companies. While we appreciate the problems commercial insurance buyers have faced over the last several years in acquiring insurance protection, I am here to tell you that repeal or modification of the McCarran-Ferguson Act will do nothing to address those problems and will probably make them worse.

Let me share with you some of my company's experience over the last several years to put you in a position or help you see my position with respect to that statement. In 1982 my company, a small, regional property casualty company represented by 350 independent agents that do business in Maine and Connecticut, wrote $31 million. Year end 1987, we will write $83 million, over a twofold increase.

Our surplus since 1982, roughly equivalent to a corporation's net worth, has increased from $35 million to a projected over $75 million by the end of 1987. Our employees, many of them women, have increased from 151 in 1983 to over 320 employees at the current time.

During 1986 alone, we wrote 12,000 new insurance policies. We gave 6.8 percent of our pre-tax income to over 93 charities. We enjoy the highest financial rating granted by the A.M. Best and Company for any property casualty company, an A-plus rating.

The significance of these facts is that, in my judgment, it would not have been possible for us to enjoy that business success without the limited protection afforded by the McCarran-Ferguson Act.

The McCarran-Ferguson Act, as it is currently constituted and as it is currently enforced, is pro, not anti-competitive, and the facts of my own company——

Senator **Metzenbaum**. Maybe you had better spell that out for us. How?

Mr. **Matschulat**. It would not have been possible for us to grow as we have been growing without three basic things; first of all, the ability to rely on the benchmark rates that are provided to us by the Insurance Services Office and by the American Association of Insurance Services—in other words, the rating bureaus.

We use the rates provided by these rating organizations through this collective activity on the part of my most intense competitors to help us gauge our rates. Our rates are, to be sure, driven by a competitive marketplace, but as a small company we cannot afford to collect the data and to analyze that data, as our larger competitors can. So we rely on the information that is provided us, the historical data, as well as the trended, updated, fully-expense-loaded data that is provided us.

We certainly do not follow those rates in our markets in Connecticut. The leading companies' rates differ substantially because of the different operating practices and operating patterns that these companies follow. But the benchmark rates, the base rates that we use is a crucial assessment of our competitive position in terms of the rates that we will charge in our marketplace provided by the Insurance Services Office. It is essential protection.

Second, we are able to compete with the very large property casualty companies because we avail ourselves of reinsurance. Third, we offer our agencies services, for example, on a collective basis through the write-your-own program provided by the federal government.

Thank you, Senator.

[Prepared statement follows:]

STATEMENT

OF THE

ALLIANCE OF AMERICAN INSURERS

By

JAMES O. MATSCHULAT
President
Middlesex Mutual Assurance Company
Middletown, Connecticut

Good morning. My name is James O. Matschulat. I am president and chief executive officer of the Middlesex Mutual Assurance Company of Middletown, Connecticut. I am here today on behalf of the Alliance of American Insurers. Our more than 175 member companies include such well-known insurers as Liberty Mutual, Kemper and Prudential Property and Casualty. They also include hundreds of smaller companies like my own. The insurance needs of millions of America's homes and businesses are the concerns of these companies. While we appreciate the problems commercial insurance buyers have faced over the last several years in acquiring insurance protection, I am here to tell you that repeal or modification of the McCarran-Ferguson Act will do nothing to address those problems, and will probably make them worse.

Insurers have come under fire in recent months. We have been faced with many charges, including collusion, boycotting and other improper business practices. I can say to you today that these charges are without merit. They have been thoroughly investigated by the federal government, and they have been shown to be false.

The insurance industry is emerging from one of the most serious times of financial difficulties we have ever faced. Some of these problems were self-inflicted because of the highly competitive nature of the industry. There are, however, continuing problems in certain lines of coverage. Over the last several years we have tried to resolve those problems in a responsible manner. Voluntary creation of markets, changes in policy forms, the creation of market assistance plans and participation with state governments in solving problems are only a few of the industry's activities over the last several years. Some of the witnesses here today have benefited from the voluntary efforts of these companies during the last year.

But I am here today to talk about the McCarran Act and its relationship to the current problems of availability and affordability. There is no relationship between McCarran's limited antitrust immunity and the problems that exist in insurance today. The repeal or modification of the McCarran Act will have no positive impact on the current situation in the insurance marketplace. Not one additional policy would be written because of amendment of McCarran, and such a change would not address any of the current shortages that exist today in the commercial liability marketplace. Medical malpractice, pollution liability, officers and directors coverage, or insurance in any of the other troubled lines will not become more available or affordable, because the costs of those products are a function of underlying loss costs and McCarran and its limited antitrust immunity have nothing to do with that. Revision of McCarran will, however, be harmful to many insurers, like my own company. Our ability to compete in different lines of insurance may be significantly harmed, and the industry's efforts to work on problems under the guidance of state insurance regulators may be severely eroded. The uncertainty that amendment of McCarran will produce about which activities are permitted or prohibited will almost certainly have a chilling effect on company activities. I do not believe that the impact these changes will have is fully appreciated.

Any review of McCarran will demonstrate these facts. The United States Department of Justice, in its recent re-examination of the situation, concluded that three of the four most commonly alleged causes of the "crisis" -- collusion among insurers, imprudent business practices and declines in investment income, and state regulation, are all unlikely to have caused the problems. Both the Federal Trade Commission and the Antitrust Division of the Justice Department have reviewed insurance industry practices and, according to my understanding, found no basis for our critics' charges.

We believe that many well-intentioned people seek an easy solution, the "magic bullet" to resolve problems. Changes in the regulatory system itself involving more regulation are not the answers to our current problems. We must, as a society, begin to examine how our current system of civil justice functions in conjunction with our risk transfer mechanism. That is one area where changes can have an impact. However, the existence of McCarran did not contribute to the current problems, and any change will not resolve the situation but will be harmful.

The current regulatory environment has allowed the property and casualty insurance business to grow and diversify as needed to meet continuing changing market demands. Yet the exemption from federal antitrust laws provided by McCarran-Ferguson has not resulted in industry concentration. In fact, most students of the property and casualty insurance industry have characterized the industry as "atomistic." The property and casualty insurance business is transacted through approximately 3500 companies. No one company has any significant degree of market penetration in the troubled commercial liability lines. The market is structured for competition and operates in a competitive manner.

The ease of entry into a market by a new company is another standard used by economists to measure the degree of competition in a market. It is generally agreed that state regulation of insurance has facilitated the entry by new companies into the property and casualty insurance field. State regulation of insurance has also fostered healthy price competition. The problem has not been a lack of competition in casualty insurance. At the same time, the insurance public has been granted protection from company insolvencies by the existence of guaranty funds.

If McCarran is repealed or modified, I will face several very difficult questions. Should my company withdraw from rating organizations? Should my company serve on joint underwriting boards, which provide hard-to-get coverages such as malpractice, windstorm, automobile and workers compensation coverages? Should my company participate in market assistance plans or assist the NAIC or individual insurance commissioners in solving problems? These are very real questions that I would have to think about very seriously. These are not matters of economic theory but practical problems that need to be considered.

If McCarran-Ferguson is changed, capacity will be reduced as smaller companies or even larger companies abandon lines of insurance in which they lack substantial market penetration. Over time there will be increased mergers, and greater market concentration than currently exists. Capital to underwrite large risks will diminish due to withdrawal from pooling mechanisms for fear of antitrust exposure. These are real consequences of changes in this industry's limited antitrust immunity.

In a review of the testimony given at the hearings in February and April before the House, I was struck by one glaring point. Not a single witness was able to detail a specific problem that would be cured by changes in the McCarran Act. Rather, we believe it has become a rallying point for some people disturbed about problems in the industry -- a solution based not on sound analysis but a belief that changes in McCarran will solve all the problems that have to do with insurance.

At the extreme, we believe that complete repeal would create considerable confusion in the marketplace. The use of standardized policy forms, which has provided consumers with the ability to shop around for the best price consistent with the service they desire, might not be permitted. Consumers can obtain automobile, workers compensation and medical malpractice insurance through joint industry pools under state regulation. Who would want to serve on these boards or in these pools? Would the risk of antitrust liability be worth the benefit?

Other insurance consumers obtain aviation coverage and high limits of property insurance through risk sharing by a number of insurers. These activities obviously serve the public interest and could be cast in doubt by a change in McCarran-Ferguson.

I caution against moving too quickly before all the facts are in about McCarran-Ferguson and our limited antitrust immunity. The Congress should not pursue such a significant change in the regulatory system without understanding the consequences of change. What will be the impact on the regulatory system at the state level or the federal level? No one knows at this point. As I previously stated, there is not one problem that has been articulated that will be cured by a change in McCarran-Ferguson.

Turning to my own company, we need the information developed by rating bureaus in order to compete in the marketplace. We could not accurately forecast the appropriate price to charge without access to industrywide data. Repeal or amendment of McCarran, of course, threatens that access. Insurance pricing is unique because of the need to make projections about the future. If we were only allowed access to industry loss costs, we would need outside actuarial assistance for pricing purposes, which most small companies, including ours, do not currently require. Cost considerations would inhibit our ability to offer the range of commercial insurance that we currently provide.

The decision to enter new states or develop new products would be much more difficult to make because of the costs involved. My company, as a small company, doesn't have the economies of scale that some of the larger companies can achieve. The use of pooling mechanisms that enable Middlesex Mutual to write high limits of property or liability insurance might not be permissible without our limited antitrust immunity.

What I do see, if McCarran is repealed or modified, is a much more concentrated industry. Over the years many new insurance products have been developed by small companies using the pooled data that is currently available. Middlesex Mutual has to provide service and competitive prices to stay in business. Our ability to do that, if McCarran is repealed, would be reduced without the information we currently receive. Information that is pro-competitive, as opposed to what many of the industry critics are saying.

Repealing McCarran and creating a system of dual regulation are not answers to our current problems. The acknowledged aim of many proponents of this legislation is not continued state regulation, but federal regulation.

Summary

In summary, let me make the following points:

- McCarran-Ferguson is the federal statutory foundation for state regulation of insurance.

- McCarran-Ferguson provides only a limited immunity from federal antitrust laws. Moreover, the immunity applies only to activities which constitute the "business of insurance" and which are "regulated by the states."

- McCarran-Ferguson does not allow the insurance industry to engage in boycotts, coercion or intimidation in the marketplace.

- McCarran-Ferguson provides no exemption from state antitrust enforcement. Every state can impose sanctions on anticompetitive conduct by insurers.

- Restricting or repealing McCarran-Ferguson would not improve the affordability or availability of commercial liability insurance. The liability crisis is the result of excess competition in commercial liability lines induced by high interest rates — combined with changes in the application of tort law and increasing costs of the legal system.

- Restricting or repealing McCarran-Ferguson could reduce the availability of coverage for high and difficult risks. One of the primary means by which insurers have addressed availability problems is by joint underwriting of risks that no single insurer could prudently underwrite itself. Without McCarran-Ferguson protection, insurers would be deterred from entering into such voluntary arrangements.

- Restricting or repealing McCarran-Ferguson would undermine reliable ratemaking. The costs that an insurer must consider in setting prices (future losses) are not known at the time prices must be established. Under the "law of large numbers" the costs can be estimated by industry cooperation in collecting past loss data and projecting it into the future. Any change in McCarran-Ferguson would result in years of litigation over the legality of these cooperative efforts.

- Restricting or repealing McCarran-Ferguson could reduce industry participation in voluntary efforts such as the Baldwin-United bail-out by casting doubt over the legality of such efforts.

- Restricting or repealing McCarran-Ferguson would not enhance competition in the insurance industry. Under the current system of state regulation the insurance industry meets and exceeds the standard tests of competitiveness -- large numbers of sellers (nearly 6,000 life, health and property/casualty companies), low barriers to entry, low market concentration (no company exceeds a 9.2% market share), price diversity, product innovation and availability of comparative information.

- Restricting or repealing McCarran-Ferguson would likely change the regulatory balance established by McCarran-Ferguson. In its absence, a dual federal/state regulatory system would be created, resulting in overlapping and confusing authority and undermining the consumer protection and solvency functions vital to the regulatory framework of insurance.

- The current system of state regulation allows states flexibility in addressing problems. Insurance remains, essentially, a local business. State insurance departments can take local economic conditions, societal attitudes and judicial precedents into account in developing and implementing regulations.

We want to cooperate with the Congress and I am willing to address problems that exist. Repealing McCarran, however, is not a solution but will create difficulties not yet imagined by the proponents of McCarran change.

We appreciate the opportunity to express our views and I will be happy to respond to any questions that members of the Committee have.

Senator **Metzenbaum**. Thank you very much, Mr. Matschulat.

Mr. Osborne, representing the National Association of Mutual Insurance Companies, we are happy to have you with us, sir.

Mr. **Osborne**. Thank you, Mr. Chairman. I might say our two States are quite a ways apart, but we do have one thing in common. We both have an OSU. You have Ohio State University and we have Oregon State. It is nice to be here today.

I would just like to respond preliminary to my remarks to the question to Commissioner Hatch by Senator Thurmond.

Senator **Metzenbaum**. Would you bring the mike just a bit closer, please?

Mr. **Osborne**. Yes.

Senator Thurmond, after the passage of the McCarran-Ferguson Act in 1945, which gave the regulation back to the States, there were model insurance laws introduced in all the States, and basically what those rating laws say, sir, is that rates will not be inadequate, they will not be unfairly discriminatory, and they will not be excessive.

So it is my perception that within our home State of Oregon where that rule applies, as I think it does in other States, that the commissioner does have the authority to police, call for hearings when he feels in his own wisdom that those three criteria are not being met.

Now, I am Chairman of the National Association of Mutual Insurance Companies. The acronym is NAMIC. We are a trade association of approximately 1,293 property and casualty companies, and I am also Chairman and CEO of the Oregon Mutual Insurance Company in McMinnville, Oregon. We write approximately $60 million in premiums in the States of Oregon, Idaho, Washington and California.

Approximately 900 member companies in the association are farm, county and township mutuals who write less than $2.5 million in premiums annually. My remarks will focus on S. 1299.

We agree with Senator Metzenbaum that continued regulation of insurance by the States is in the public interest. We do not agree, however, with the contention that competition has been reduced to the detriment of insurance consumers because of the current limited exemption from Federal antitrust laws.

On the contrary, that exemption makes it possible for companies to effectively compete in speciality areas, as well as the general insurance marketplace. NAMIC has surveyed its membership to determine their level of participation in joint insurance activities such as data-sharing and the importance of such participation.

My comments today are based upon a preliminary analysis of survey results. A detailed report will be filed with the full committee in mid-June. The foremost conclusion to be drawn from respondents' answers is that the present structure of State regulatory primacy coupled with the narrow exemption from Federal antitrust statutes does indeed encourage competition in the insurance marketplace.

It allows smaller companies to meet existing needs and to expand and serve the future needs of the consumer. This issue actually affects both small and large companies. Multi-line regional and larger companies may find they are more restricted than small companies because of expansion into new territories or additional lines of coverage with limited data of their own.

Our members indicate the ability to share a wide variety of data is important in their rating process. Of those responding, 86 percent share data in some fashion. The availability of data on past losses held the highest priority for ratemaking purposes for those respondents who share information.

Of the 74 percent who make up the data, 69 percent felt they could not do business without it. Respondents would experience substantial additional operating costs which would be passed on to policyholders through increased premiums.

Further, companies would be reluctant to offer new coverages or make changes in existing contracts, with the result that consumers who need such innovation would be unserved.

Seventy-three percent of the respondents used standard policy forms; 71 percent of these considered them absolutely essential to continued operations. By providing a greater statistical base, shared information allows for greater credibility in the ratemaking process.

We feel the proposed legislation would curtail development of reinsurance pools and joint underwriting efforts. One thing is clear. Respondents generally do not believe that repeal of the McCarran-Ferguson Act would make insurance more readily available and affordable.

Senator **Metzenbaum**. Thank you very much, Mr. Osborne.

Mr. **Osborne**. Thank you.

[Prepared statement follows:]

STATEMENT OF THE
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES
BEFORE THE
SENATE JUDICIARY COMMITTEE
JUNE 2, 1987

PRESENTED BY
JAMES L. OSBORNE
CHAIRMAN, NAMIC
AND
CHAIRMAN, CEO
OREGON MUTUAL INSURANCE COMPANY

Mr. Chairman and members of the Committee...

My name is James L. Osborne. I am Chairman and Chief Executive Officer of the Oregon Mutual Insurance Company, a property/casualty insurance company domiciled in Oregon and writing business in Oregon, Idaho, Washington and California. In 1986, my company had direct written premiums of $ 60 million. The Oregon Mutual Insurance Company is what is termed a regional, medium-sized insurer.

I am also appearing here today in my capacity as Chairman of the National Association of Mutual Insurance Companies (NAMIC). NAMIC is a trade association of 1,293 property and casualty insurance companies. Members are located throughout 47 states and range in size from the largest national property and casualty insurers to the very smallest local writers.

Many NAMIC companies offer farm property insurance only - either by choice or by state law. Designated as "farm", "county", or "township" mutuals, these are truly the small companies in the property and casualty insurance industry. Approximately 900 members write less than $2.5 million in premiums each year, including the almost 450 companies that write annual premiums of $350,000 or less.

Farm mutuals generally operate in one state only - and oftentimes in a township, one county or several contiguous counties within that one state. Small, farm mutuals have existed many decades to fill a critical market void by providing competitive insurance coverages to the agricultural community.

Remaining companies in the NAMIC membership are regional multi-line insurers (doing business in from one to perhaps 10 states at annual premium levels of up to $100 million), and national carriers whose premiums exceed $100 million per year. These small and medium-sized companies as well as many of the national companies provide excellent services in a competitive atmosphere. These are the companies who provide insurance coverage to new entrepreneurs who are entering new businesses, the free enterprise system working at its best.

Recent problems in commercial liability insurance markets have led to charges that the present system of insurance regulation encourages insurance companies to engage in anti-competitive practices, most notable price-fixing. Extremely competitive underwriting and pricing practices occurred in the late 1970's and early 80's in the commercial lines of property/casualty insurance. That, along with changes occurring in the judicial system and society, created the current conservative underwriting and pricing environment.

Suggested remedies for this liability crisis, including Senator Metzenbaum's most recent proposal, seek to repeal completely or limit further the insurance industry's already narrow antitrust exemption under the McCarran-Ferguson Act while maintaining the right of the individual states to regulate and tax the business of insurance.

My remarks today will focus on the intent of initiatives such as Senator Metzenbaum's proposed legislation.

The current debate is important to NAMIC members because it has the potential to dramatically affect their ability to expand and provide competitive insurance to the public. We agree with Senator Metzenbaum that continued regulation of insurance by the states is in the public interest. We do not agree, however, with the contention that competition has been reduced, to the detriment of insurance consumers, because of the current exemption from federal antitrust laws afforded the insurance industry by the McCarran-Ferguson Act. On the contrary, that exemption makes it possible for companies to effectively compete in specialty areas as well as in the general insurance marketplace.

Modification of McCarran-Ferguson to define its antitrust provision even more narrowly would only serve to restrict competition, rather than increasing it.

NAMIC member companies are predominantly local operations, involved only in the business of insurance. These are the companies that provide stability and a competitive continuity to the property/casualty insurance industry. They are primarily personal lines companies, with heavy emphasis in the agricultural community with more than 100 years operating experience in many cases. While industry giants (including our own member companies) routinely experience great fluctuations in their underwriting cycles, moving in and out of various insurance markets, the smaller companies consistently provide excellent coverage and service to their regional and local consumers.

Mutual insurance itself, based upon the principle of providing sound security at a reasonable cost, was developed in response to the various periods of insurance availability and affordability constriction that have taken place in the course of our nation's history. First applied in this country in 1752, the mutual insurance concept has since been steadily adapted and extended to provide protection to factory owners, farmers, grain dealers and to every other segment of business and industry.

Mutual insurance companies were often pioneers, furnishing coverages to areas of the economy where the lack of insurance at reasonable cost hindered progress. NAMIC's members have been and continue to be in the forefront of those efforts.

The McCarran-Ferguson controversy is, in large part, an outgrowth of questions as to the effectiveness of the present system of state regulation of insurance and whether the need exists for federal involvement in insurance regulation. Of greatest importance, however, is the effect any change would have on the insurance marketplace and on the insurance consumer.

NAMIC has surveyed its membership in an attempt to answer these questions. Members were asked to indicate the extent to which they engage in data sharing activities (both formal and informal) and the importance of those activities to company operations. The survey also attempted to determine the level of participation in joint insurance activities and the importance of such participation. Finally, NAMIC sought to measure individual perceptions concerning regulation of the insurance industry.

The survey questionnaire (ATTACHMENT 1) was mailed to 1,223 members (member companies located outside the United States & certain Associate members - primarily computer software companies - were excluded) on March 18, 1987. By April 30, 545 completed questionnaires had been received, resulting in a response rate of 45%. A comparison of responding companies and the NAMIC membership indicates that respondents provide a fairly representative sample of the membership.

My comments today are based upon preliminary analysis of survey results. NAMIC is now preparing a detailed report on those findings which will be provided to members of this committee by mid-June.

The foremost conclusion to be drawn from respondents' answers is that the present structure of state regulatory primacy, coupled with the narrow exemption from federal antitrust statutes afforded by McCarran-Ferguson, does indeed encourage competition in the insurance marketplace. It has allowed smaller companies especially to meet existing needs and to expand to meet the future needs of their neighbors.

That is not to say, however, that this issue is one which affects only small companies. The effects of any change would be felt immediately by those insurance companies whose annual premiums are between $2.5 and $100 million, but eventually there would also be some impact on large insurers as well. In fact the regional and larger companies that provide many types of coverages in several states may find they are more restricted than very small companies. This is due to the fact they are expanding into new territories or additional lines of coverage with limited data of their own.

The limited antitrust exemption provided by the McCarran-Ferguson Act makes it possible for insurers to, among other things, compare their loss data with that of other companies to develop a more accurate picture of the potential loss they are insuring; study general industry coverages, policy forms and rating scales to develop a competitive product and set a realistic price for it; create a spread of risks among themselves within underwriting and reinsurance pools to increase capacity. While these activities are critical to smaller operations, who otherwise could not afford the actuarial and legal expertise necessary to develop the information individually, they are also important to larger companies. Having access to pertinent statistics and joint efforts enables them to expand into new nontraditional coverage areas, thus creating capacity and providing insurance protection to markets not previously served.

The ability to share information under the current regulatory system works to the benefit of the insurance consumer, according to survey results. By comparing loss experiences, having access to standard policy coverages and forms, and participating in reinsurance pools, respondents minimize their own costs and pass the savings to their policyholders.

Our members indicate that the ability to share a wide variety of data is important to their rating process. Of those responding, 86% share data in some fashion. More than half (53%) do so formally through statistical organizations such as the Insurance Services Office (ISO), the American Association of Insurance Services (AAIS) and the National Independent Statistical Service (NISS). Several also use more informal channels such as statistics disseminated by their reinsurers, a network of local companies, or their data processing firms.

The availability, for ratemaking purposes, of data on past losses held the highest priority for those respondents who share information. Of the 74% who make use of that data, 69% felt they could not do business without it; 30% could continue to operate without using past loss data but, lacking a broad base from which to develop statistically valid rate schedules, saw themselves probably forced to leave the general insurance marketplace and to restrict the variety of lines and types of exposures they insure to "perfect" risks.

Respondents generally felt that this bias towards conservatism plus substantial additional operating costs, would be passed on to policyholders through increased premiums. Further, companies would be reluctant to offer new coverages or make changes in existing contracts because of the difficulty in assessing the implications of those changes, with the result that consumers who need such innovations would go unserved.

Standard policy forms and coverages followed very closely as a vital component in pricing; 73 percent of the respondents use them. Seventy-one percent of those consider them absolutely essential to continued operation.

Uniform coverages and policy forms allow insurers to provide service and progress with the development of new insurance products. They also provide a source of stability, offering a general assurance that individual, insured members of the public have the same basic coverage for like risks even though they're insured by different companies. Further, without standardized information, policyholders would have to become legal experts themselves in order to be certain they're sufficiently protected.

Approximately one-half of the companies that share statistical information also utilize expense data, definitions of class plans and territories, advisory rates, loss trending data, town gradings or loss development factors when considering the appropriate price for their products. It is generally the small to medium-sized multi-line company whose book of business is complex enough to require the use of such information, but whose volume of business is, alone, insufficient to provide credible statistics, that relies on access to this data in the ratemaking process.

Overall, the primary benefit of sharing statistical data lies in the fact that it enables companies to compete effectively in the marketplace. Shared information on the causes of certain kinds of losses and how other companies are dealing with them helps insurers properly evaluate the risks they choose to insure and the appropriate rate to be charged. By providing a greater statistical base, shared information allows for greater credibility in the ratemaking process. Finally, access to industry-wide data makes it possible for insurance companies to develop new products and enter new markets - business practices that directly benefit the insurance consumer.

Participation in activities such as reinsurance pools and joint underwriting efforts further enhances respondents competitive positions, according to survey results.

Forty-six percent of our respondents participate in reinsurance pools. Of those, 80% have indicated that they would be unable to do business without participating; 16% could continue to operate, but would do so on an impaired footing.

Reinsurance is important to small and medium-sized insurers, and critical to the very small, farm mutual companies. Reinsurance pools help very small writers especially by creating capacity to write larger risks, making it possible for them to grow and move into new markets.

While increased capacity to write insurance is perhaps the most obvious benefit to smaller companies of participating in a reinsurance pool, it is by no means the only one. Involvement in this activity also allows small and medium-sized insurers to undertake joint research, risk inspection and loss prevention efforts. Reinsurance pools help small and medium-sized companies stabilize rates and prevent large rate changes due to catastrophic losses.

It is appropriate at this point to comment upon the inter-relationships between the various segments of the property/casualty insurance industry and the value of their joint activities, to the insurance provider and the insurance consumer.

As I have already mentioned, when reinsurers group small or medium-sized companies together to form a reinsurance pool they create increased capacity to offer coverages for risks that those direct writers would otherwise be unable to insure. Results from joint research, the joint inspection of common risks, and joint efforts to educate policyholders, and therefore prevent losses from occurring in the first place, all contribute to holding the line on expenses and, ultimately, insurance costs to the consumer.

Combining resources to provide insurance through joint underwriting efforts also makes it possible to cover larger, high-level risks that are difficult to insure within the traditional insurance mechanism.

Interaction between the multiple segments produces a strong competitive balance within the property/casualty insurance industry. Small and medium-sized companies look to reinsurers for greater capacity to provide insurance; while reinsurers, by their nature and purpose, exist simply to meet the needs of direct writers. Smaller operations look to larger companies, and the industry as as a whole, for a broad base of experience and research from which to develop valid underwriting and rating standards. On the other hand, national carriers realize that small and medium-sized insurers occupy an important place in meeting the specific insurance needs of their local policyholders.

The existence of the very small, farm mutual companies serves a very important purpose. A strong relationship with their policyholders and an unparalleled understanding of their unique product enables them to offer sound protection at reasonable cost, acting as a curb to artificially high rates in the local marketplace.

Preliminary analysis of our survey results indicates that access to industry statistics and the ability to participate in certain joint undertakings are key factors that allow companies to compete in the insurance marketplace. These activities permitted by McCarran-Ferguson lead to increased capacity and greater ability to meet the present and future insurance needs of consumers.

Respondents were also asked their opinion on how effective the federal government would be as compared to the states in the regulation of rates, market conduct, and risk classifications; in regulating for solvency; in gathering and disseminating loss data; and in managing insurance pools and residual markets. The vast majority felt that federal regulators would be LESS EFFECTIVE than the state governments in all areas.

Eighty-two percent believe the states would do a better job of regulating rates; 75 percent indicated that federal regulators would not be effective in setting risk classification guidelines; and 74 percent feel that market conduct would be better regulated on the state level.

Overall, respondents felt that the states do a much better job of regulating insurance companies than the federal government could do. Insurance companies are seen as being more strictly regulated than most other industries because of state regulation, but few believe that additional regulation would make them operate more effectively.

Our survey sheds light on the degree to which NAMIC members engage in various shared activities. Some uncertainty remains, however, as to the ultimate effect of prohibiting those activities. Most respondents would stay in business, but at a much greater cost and on a more limited scale. The greatest impact would be seen in respondents' inability to develop new products or enter new markets.

One thing is clear, respondents generally do not believe that repeal of the McCarran-Ferguson Act would make insurance more readily available or affordable. There is no relationship between the Act's limited antitrust immunity and the problems that exist in insurance today. Repealing or modifying McCarran-Ferguson in hopes of providing an immediate solution to recent problems experienced in the insurance marketplace will not resolve the situation but not only make it worse.

The proposed legislation states as its purpose the promotion of price competition among insurers through modification of the insurance industry's current antitrust exemption under the McCarran-Ferguson Act. The results of the NAMIC survey suggest that such competition already exists within the present scheme. In fact, it is very much alive and well. We see no need, therefore to fix what is not broken.

While it is impossible to know exactly what the impact of repealing or modifying the McCarran-Ferguson Act would be, we can offer some good general possibilities. Without the ability to share information, for example, small and medium-sized companies would lack a broad statistical base to provide credible data, making it extremely difficult (if not impossible) to develop sound rate schedules. Many companies would probably withdraw from all but "perfect" risks. Those that continued to offer coverage would face higher costs in reflection of increased uncertainty, and all but the very largest companies would avoid the development of new products.

It is almost impossible for small and medium-sized companies to individually develop new products and forms due to the lack of in-house actuarial and legal expertise. Were these companies denied access to shared data on industry experience, they could not grow. Capacity to meet policyholder needs would be reduced and competition would be severely restricted.

A major cause for concern in this discussion is the great degree of uncertainty attendant to any change. Will insurers be subject to antitrust scrutiny if they participate in market assistance plans? Should companies withdraw from statistical organizations? All we can predict with any certainty is that insurers would face years of litigation to settle even the most simple of questions.

Equally disturbing is the potential for dual state/federal regulation or for more restrictive state regulation of insurance if the present system is altered. Changes leading to federal involvement or to extremely stringent state requirements would increase operating expenses for smaller companies. Without a large policyholder and premium base to absorb such cost, expansion into new markets would be curtailed, effectively limiting the ability of those companies to compete. Is this what reformers intend?

Proponents of legislative initiatives to modify or eliminate the limited antitrust exemption afforded insurers under McCarran-Ferguson contend that the current situation weakens competition, to the detriment of insurance consumers. I contend that the reverse is true: access to shared data and the ability to engage in joint activities - all now permitted under the Act - benefit the consumer by enabling insurers, especially the small ones, to grow and compete.

I would also remind you that small and medium-sized companies have been consistent providers of insurance to homeowners and small-business owners whether the market is "soft" or "hard." They have been able to fulfill that role because of the cooperative activities they may pursue under the McCarran-Ferguson Act. Elimination or change of the antitrust exemption resulting in prohibitions against that activity would limit the ability of those companies to play the same role in the future or to expand their capabilities. Large companies would be reluctant to enter new lines, as well, without a sufficient statistical base to justify business decisions affecting those markets.

The current basic antitrust policy embodied in the McCarran-Ferguson Act is reasonable and consistent and offers a healthy environment in which NAMIC member companies can compete. I urge you to consider very carefully whether changing that policy in any manner will truly benefit the insuring public or will harm them. NAMIC believes that the result of change will be to reduce capacity, limit expansion, restrict available coverages and raise the cost of insurance to consumers.

Thank you for the opportunity to appear here today. I would be glad to respond to your questions.

Senator **Metzenbaum**. Mr. Jones, we are happy to hear from you. Will you tell us whom you represent, or are you speaking for yourself?

Mr. **Jones**. I am speaking for myself.

Senator **Metzenbaum**. All right.

Mr. **Jones**. Thank you very much for filing my full statement. My name is T. Lawrence Jones and I am counsel to the law firm of Hunton and Williams in their Washington office. My firm has authorized my appearance, but what I have to say are my personal views.

For approximately 19 years, I served as President and Chief Executive Officer of the American Insurance Association. One of our prime responsibilities was McCarran-Ferguson. We supported McCarran-Ferguson; the association still supports it. We prepared reports to Congress on its operation.

In my statement, I have said and pointed out that S. 1299, which we are addressing today, does not address the problem that was the liability insurance crisis. McCarran-Ferguson is a false issue there.

It was not lack of competition, but it was excessive competition that resulted in the liability insurance crisis.

We were also able to observe in our working with McCarran-Ferguson that it was not a barrier to competition or to the growth of competition. Sometimes, there were those who felt that State regulation was an impediment, but not a barrier in any sense to the growth of competition, and certainly McCarran-Ferguson was not a barrier.

I have put a brief history in my statement about the development of competition under McCarran-Ferguson, and the point being that it really has not been a barrier. Now, in spite of this explanation of the fact that the antitrust laws were not the cause or will not remedy the liability insurance crisis, the Congress does seem to wish to address the subject of McCarran-Ferguson, and I would like to make a few brief comments about the bill maybe to improve it.

First, it calls for fraud reports to be filed, and I would like to say that that is not an appropriate way to go. We used to operate a fraud and arson bureau. It is mostly for law enforcement purposes. There has to be confidentiality of the information.

Senator **Thurmond**. Mr. Jones, speak in your machine so we can hear you a little better.

Mr. **Jones**. All right.

If you file it routinely, it will be available for people that might stop the investigation or cause trouble in the investigation. We actually had situations where the local prosecutor was a member of the fraud ring, and we have had situations where a powerful political person was part of the ring in the State and we had to go to the Federal Government, to the U.S. Postal Service for prosecution. So there should not be routine filing of the fraud investigations. We also had a lot of defamation suits; we usually had six pending. We always won them because we were very careful, but they were expensive to defend.

I suggest that you recognize the need for joint research. Particularly, what seems to be missing to me is addressing the subject of rating manuals and final rates. There is a need, particularly on the part of the smaller companies, to find a way to prepare these very complicated manuals, divided by territories, classification, age, type of property, et cetera.

It is a very expensive process, as I have pointed out, and I think it should be clarified as to what the smaller companies can do in the way of joint activity towards getting a rating manual and also getting a final rate. Both of these gentlemen here, their companies deserve that kind of special attention, and I would urge the committee to address their problems.

Also, in compiling the historical data, I think the bill limits too much what can be included. You need to include incurred-but-not-reported losses also.

There is another side to your bill, though, Senator. It is an opportunity for the industry to address the subject of McCarran-Ferguson. It is a false issue now, it has been a false issue before, and I would urge the industry to work with the committee. The bill is a good start towards addressing the subject of McCarran-Ferguson and putting it in a proper perspective in defining the relationship between the industry and the antitrust laws.

There is already competition there. State regulation, you confirm; State taxation, you confirm. You recognize many of the—in fact, I think you have recognized the essential joint activities that the industry has to have in order to function as an efficient industry in providing the coverages.

I would strongly hope and urge that the industry would come in and work with you in making the bill complete and making it workable.

[Prepared statement follows:]

STATEMENT

OF

T. LAWRENCE JONES

COUNSEL

HUNTON & WILLIAMS

My name is T. Lawrence Jones. I am Counsel to the firm of Hunton & Williams in its Washington office. I am pleased to respond to the invitation of the committee to comment on S 1299.

Although my firm has authorized my appearance, the opinions that I express will be my own. Hunton & Williams is not employed by any clients to support or oppose the enactment of legislation like or similar to that before the committee.

For approximately nineteen years, I served as President of the American Insurance Association, a national trade association for property-casualty insurance companies. One of the principal responsibilities of the association during that period of time was to respond to inquiries from congressional committees regarding the operations of the insurance industry under the McCarran-Ferguson Act. The association supported McCarran-Ferguson and was opposed to modification or repeal of that Act. We conducted periodic studies of the industry's operations under the Act. It was our observation that competitive forces continually increased and expanded notwithstanding any provision or application of the McCarran-Ferguson Act.

Beginning in 1969 and 1970 there was a corresponding change in state rating laws which further encouraged the growth and extent of competition in the property-casualty insurance industry. These new laws were competitive type rating laws. In the states in which they were enacted, they replaced the strict rating laws which required the state regulator's approval before new rates could be used.

Under the old rating laws passed after the enactment of McCarran Ferguson, the state regulators increasingly required massive amounts of historical data to justify any rate increase. The industry thought on some occasions these calls for data were more for the purpose of delay than for the need of more information. These demands for collective historical data encouraged the use of rating bureaus to collect the information from and for subscribing companies. There were many such rating bureaus; some representing one line of insurance and some representing just a regional area. Each rating bureau had its own history, but their practices and procedures did not serve as a barrier to the growth and extent of competition.

Also following the enactment of McCarran-Ferguson, there was a steady growth of companies that did not subscribe to rating bureaus. They are called independent companies meaning they operate independently of the rating bureaus. The independent companies, through their separate trade association, the National Association of Independent Insurers, developed their own data gathering system for the purpose of meeting statutory requirements for reporting data. It was a simpler form of reporting designed primarily to meet statutory requirements for reporting. As developed, it was a different approach to data gathering and a competing system to the one used by the companies subscribing to the rating bureaus. With the growth of competition the division between the two groups has diminished.

In part due to the success of the independent companies and to the introduction of the new competitive type rating laws, most of the existing rating bureaus were merged into the organization we know today as the Insurance Services Office, Inc. Others ceased to exist. Today some companies report data to both the National Association of Independent Insurers and the Insurance Services Office.

After the enactment of the competitive rating law for automobile insurance in New York State, the Insurance Services Office adjusted its practices and procedures to meet the antitrust provisions of the New York enactment. (Book 27 McKinney's Consolidated Laws of New York Annotated, Article 23.16, Prohibition of Anti-competitive Behavior).

The purpose of relating this brief history of state regulation of insurance is to illustrate that McCarran-Ferguson has not impeded the growth of competition in the property-casualty insurance industry. I have had the opportunity to be a participant and an observer of the continuous growth of competition among insurance companies and the development of alternatives to insurance which in turn serve as a spur to competition.

The enactment of S. 1299 is not necessary for the existence and growth of competition. There is a great amount of competition in the insurance industry. The exception would be what are called the "troubled lines" of insurance. But this bill would not facilitate or encourage the finding of solutions to those "troubled lines".

Second, this legislation does not address the problems of restricted or nonavailable liability insurance, particularly for certain businesses and professions which so concerned the Congress last year. There are many explanations for that liability insurance crisis. It is my opinion that the main cause was intense competition and price cutting in the commercial lines of insurance from 1979 through the first half of 1985. One insurance company executive recently characterized the competition during that period as immature competition. I would agree with that characterization. Nevertheless, it was competition, and it was very intense.

The prolonged price cutting eventually reached the point of creating what is known in the industry as the "capital squeeze". When the price cutting resulted in net operating losses, premium increases were in order. Under state regulation, there are capital requirements supporting a company's premium volume. When premiums were increased, capital resources, defined as policyholders' surplus, had to increase or the company was forced to elect which business it would keep. Many companies elected against what we today call "troubled lines".

If in spite of this or any other explanation of the liability insurance crisis the Congress wants to act, I would like to make some observations about the legislation which hopefully will improve it.

In the new Section 3.(b)(4) the bill recognizes that joint action is necessary in "collecting, compiling and distributing information relating to fraudulent claims and fraudulent practices" if there is to be an effective program against such fraudulent activities. But the subsection has a proviso that such information is made available to an appropriate state regulatory agency.

I would advise against the proviso. There have been instances where the local prosecutor or a politically powerful person in a state has been involved in fraud rings. In those cases it was necessary to go to federal agencies for prosecution. An early disclosure to a state regulatory agency could compromise the development of the case against such fraud rings.

The compiling and use of information about fraudulent claims has led to some private defamation actions. The routine filing of such information with a state regulatory action could easily increase unnecessarily those suits. After preliminary accumulation of questionable claims or possibly duplicate claims, the industry organization might determine that the claims or the practice were not fraudulent. Yet it might have been routinely filed with the state regulatory agency before that determination.

As an alternative the committee should consider having the proviso read as follows: "provided that any dissemination of such information is consistent with state and federal laws."

After detailed coverage of some constructive joint activities of the industry, the bill does not expressly address the subject of rating manuals. The implication is that each company will develop its own rating manuals. This is feasible only for large companies and specialty companies. It is not practical for small companies.

The expense of development, printing and distribution of manuals is considerable. That expense becomes a relatively small item for a large company, but a relatively large expense for small companies. These smaller companies frequently efficiently serve markets overlooked in the marketing plans of the larger insurance companies. I would recommend special provisions for joint activity of smaller companies in developing rating manuals or authorization to obtain them from an independent service company.

I would recommend that there be authorization and recognition of the need for joint research. There are coverage problems that still need to be solved such as environmental liability. Some of the unsolved insurance problems, including environmental liability, require the resources of more than one company. It is assumed that research done at the request of some state regulatory agency would be protected from the federal antitrust laws because of the request coming from a state agency. But all problems should not have to wait until a state request for research is needed.

In the effort to reduce and control the amount of claim information that can be jointly collected, compiled and disseminated, section 3(b)(1) may develop information that is more confusing than helpful to state regulatory agencies. This subsection restricts the joint collecting, compiling and disseminating of historical data to paid claims or reserves for reported claims. The resulting information will not correspond to the annual reports filed by the companies nor will the information correspond to any material submitted to the regulatory agency in support of a rate filing or justification for a rate in use.

The historical data on "reserves for claims" will not correspond with "reserves for claims" in the annual statements. Missing will be the reserves for the "incurred-but-not-reported" claims. One can understand the frustration of determining and verifying incurred-but-not-reported claims, but they are very real. The reserves for those claims must be be reported in state regulatory statements and in financial statements.

In any rate filings two factors will be missing: first, the reserves for incurred-but-not-reported claims and also trending factors applied to the historical data.

Apparently the intent of the bill is that each company should determine its own reserves for incurred-but-not reported claims. But that is the practice today. The reporting of each company's individually determined reserves for incurred-but-not-reported claims to an advisory organization could not be anti-competitive. The inclusion of those additional claims would make the compiled historical data correspond with the claim experience reported in statements filed by the companies with the state agencies. The development of reserves for incurred-but-not-reported claims is an individual company matter and not a collective or joint activity. A suggested amendment is described in an appendix to this statement.

Trending factors are a different matter. Historically the trending factors have been developed by the compiler of historical data. It would appear that the intent of the legislation is to have the companies independently develop their own trending factors or to retain advisory service other than the compiler for the purpose of accumulating trending factors from the historical data and other economic data from a variety of sources. This provision could result in a whole new industry, and it is assumed that that is one of the objectives of the legislation.

Premium rates have to be developed somewhere. Not all companies are in the position to develop premium rates from within their own organization. No doubt other service organizations will be created to develop final premium rates. These new organizations will operate in a manner that will not be collective activity by their subscribers. The organizations will be sellers of a finished product - the premium rates for classes of risks; and the subscribers will be purchasers of a final product. If this result is the intended objective of the bill, it is desirable that the legislative history clearly reflect that this practice is consistent with the intent of the legislation.

Having made these critical comments on the bill there is also much that can be said for it. It reaffirms state regulation and taxation of insurance. It specifically recognizes and authorizes the joint activities that are essential to the efficient and effective operations of the industry. I believe the list is complete. If it is not, the committee could complete the list of necessary or desirable joint activities by consultation with the industry.

I have endeavored to make my points: (1) that the McCarran- Ferguson Act is a false issue concerning the liability insurance crisis, and (2) that there is real and extensive competition in the industry. McCarran-Ferguson has not served as a barrier to the growth of that competition. The Act has been a false issue on other occasions as well.

Understandably the insurance industry has an attachment and proprietary interest in McCarran-Ferguson. Forty-two years ago the industry worked hard to pass it. The state regulators worked hard to pass it. The industry and regulators eventually worked together to pass it. It is the major federal legislation concerning the insurance industry.

One wonders if McCarran-Ferguson has not served its purposes. Today there is real competition throughout the industry. Advisory organizations operate in compliance with strict state antitrust laws. State regulation is mature and firmly established. State taxation is in place and secure.

From time to time, even before National Commissions, the insurance industry has faced criticism and been accused of having special privileges under our national laws. The public perception has been that McCarran-Ferguson has given the industry a greater exemption from the federal antitrust laws than was ever the case.

A time and opportunity has come for the insurance industry to rid itself of the negative public and official attitudes stemming from McCarran-Ferguson. The committee's bill reaffirms state regulation and taxation. Those were among the primary purposes of McCarran Ferguson in the first instance. It was the issue of state taxation that broke the logjam for its enactment in the Senate 42 years ago. The bill recognizes and authorizes the joint activities used and needed by the insurance system, subject to the comments above. The committee could satisfy itself as to the completeness and adequacy of its list.

Speaking for myself, I believe that the insurance industry would be wise to seize this opportunity and work with the committee and the other relevant committees of the Congress to redefine the relationship of the federal antitrust laws to the industry and state regulation. I know that some of my present colleagues agree with me. I trust that there are others. In my opinion the committee's bill is an excellent start.

Thank you for the invitation to appear. I appreciate the opportunity to express these views and make these recommendations to the committee.

Suggested Amendments

Amend new section 3(b)(1) being added by Section 3(c) of the bill as follows:

Add after "reported claims" a comma, and inserting the following: "and reserves for incurred-but-not-reported claims".

Amend new section 3.(b)(4) being added by Section 3(c) of the bill as follows:

After the comma following the words "fraudulent practices" strike out the rest of the subsection and substitute the following:

"provided that any dissemination of such information is consistent with state and federal laws".

Senator **Metzenbaum**. Thank you very much, Mr. Jones. I will have some questions for you shortly.

Mr. Mullen.

Mr. **Mullen**. Thank you, Mr. Chairman. Mr. Chairman and members of the committee, I appreciate the opportunity to testify today on legislation that would apply the antitrust laws to the business of insurance.

I strongly support the application of the antitrust laws to the business of insurance because it will promote competition. It will clearly establish competition as the guiding principle for pricing the business of insurance. It is consistent with our strong national policy in favor of free markets and competition, and, if it is carefully crafted, this legislation can promote competition without imposing undue burdens on small insurance companies.

I am Michael Mullen, of counsel to the Washington, D.C. law firm of Crowell and Moring. For the past 15 years, first as counsel to this committee and later as counsel to the Senate Committee on Commerce, Science and Transportation and more recently in private law practice, I have had the opportunity to observe the insurance industry and its regulation.

Based on that experience, I am absolutely convinced that the application of the antitrust laws to the business of insurance is in the national interest. I am appearing today at the invitation of the committee and my testimony is based on my personal views, not on the views of our law firm or any of its clients.

I believe that the insurance industry serves an important and very substantial national economic and social interest, and I would not take the position that I am taking today if I thought that the application of the antitrust laws would harm the insurance industry's long-term vital interests.

Mr. Chairman, the insurance industry is very competitive. I have a bar chart which compares on one side the combined market share of the four largest companies in three major lines of insurance.[1]

First, in homeowners insurance, there is 36 percent market share among the top four companies; in commercial auto, 17 percent; in private passenger auto, 38 percent. These are relatively low concentrations for the four top companies if you compare them with some manufacturing industries shown on the other side—soft drinks, 15 percent; greeting cards, 80 percent; cement, 32 percent; and primary aluminum, 67 percent.

I think the insurance industry itself takes the position that it is very competitive. And, if it is very competitive, then what is the argument for not applying the antitrust laws?

Can you imagine if a group of auto dealers came to the committee and said we are very competitive; we have sales, we have discounts, financing deals? Large sectors of the American economy would not be under the antitrust laws if Congress took that position.

So, if there is any justification for an antitrust exemption, it has to be something else, and I think that something else is the unique character of the insurance contract. Under an insurance policy the company, for a fixed amount of premiums, promises to pay a somewhat uncertain number of claims that will arise in the future.

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[1] The chart appears at the end of the prepared statement.

A small company might not have a large enough sector of the insurance market to know exactly what its reasonably expected future claims will be. So I support that aspect your new bill, S. 1299, which permits the sharing of loss data.

The bill needs to be reviewed carefully to see exactly how this system of sharing loss data would work, but the basic idea, I think, is that the antitrust laws should not provide an exemption any larger than the justification for the exemption: to share loss data, perhaps to let the companies create common policy forms, and to engage in other similar activities.

Now, Mr. Chairman, I would also like to comment on the adjustment of loss data because I think that is an important policy issue and an important technical question. I have a chart here that just shows schematically what we are talking about with loss trends.[2]

Individual companies are going to report different amounts of aggregate losses for a particular class of insurance from year to year, and those losses are going to go up and down, but generally up. Now, one of the problems you face when you are trying to figure out how to operate the sharing and collection of data, is what adjustments do you allow.

Do you just permit the companies share the raw data, or do you allow them to adjust that data to bring it up to the present time, or do you allow them to project it into the future?

I think very clearly that if you restrict the loss-sharing too much, it will be detrimental; it will hurt competition. So I think that the legislation should permit some adjustment of the costs, at least to show the present value of losses—and loss aadjustment expenses.

And depending on what requirements you impose to assure that companies use appropriate statistical rules and appropriate economic indicators, I think that you need to give serious consideration as to whether or not any additional adjustment is needed or should be permitted.

Mr. Chairman, I just want to show one more chart here which I think illustrates another important point.[2] What we are talking about is sharing "loss cost data." For property—casualty liability insurance, "loss costs" are somewhere between 60 and 75 percent of the total dollars for premium.

Now, this part is what the insurers need to find out: what is their average expected loss cost. They do not need to share information or find out about what their expenses or profits are. So I think that if you limit the bill to sharing expected loss costs or calculating that amount based on prior loss costs, that is all the further you need to go.

In closing, Mr. Chairman, I would just like to say there are a number of explicit antitrust exemptions contained in Senator Simon's bill, S. 804, that I think are generally consistent with permitted activity for trade associations and other organizations under the antitrust laws.

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[2] The chart appears at the end of the prepared statement.

Because there is so much fear and concern in the insurance industry, I would urge the committee to give some consideration to making some of the other matters explicit in this legislation.

Thank you. I will be happy to answer any questions.

[Prepared statement follows:]

STATEMENT OF
MICHAEL J. MULLEN, OF COUNSEL
CROWELL & MORING

BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

Mr. Chairman and members of the Committee, thank you for the invitation to testify on legislation that would apply the antitrust laws to the business of insurance. I strongly support application of the antitrust laws to the business of insurance because --

- it will promote competition;
- it will clearly establish competition as the guiding principle for pricing in the insurance business;
- it is consistent with our strong national policy in favor of free markets and competition; and,
- if carefully crafted, this legislation can promote competition without imposing undue burdens on small insurance companies.

My name is Michael J. Mullen. I am Of Counsel to the Washington, D.C. law firm of Crowell & Moring. For the past 15 years, first as a counsel to this Committee, and later as a counsel to the Senate Committee on Commerce, Science and Transportation, and more recently in private law practice, I have had the opportunity to observe the insurance industry and its regulation. Based on that experience, I am convinced beyond a reasonable doubt that the application of the antitrust laws to the business of insurance is in the national interest.

I am appearing today at the invitation of the Committee and my testimony is based on my personal views regarding sound antitrust policy; my testimony does not reflect the views of our firm or any of its clients.

SUMMARY

The main points I will make in my testimony are:

- that the insurance industry is competitively structured, and is generally, very competitive;

- that if the antitrust laws apply to the business of insurance, they should include an exemption for certain permitted joint activities that are related to the collection of statistical data (including losses) that are beneficial, if not essential, to permit insurance companies to establish sound rates and premiums for various lines and classes of insurance;
- that Congress should preempt state rate regulation to avoid nullification of its action and to avoid confusion regarding the application of the "uncertain" state action doctrine to ratemaking activities;
- that Congress should not simply repeal the McCarran-Ferguson Act outright and rely solely on the state action doctrine;
- that the application of the antitrust laws to the business of insurance will not hinder state insurance regulation regarding the licensing of companies and agents and the regulation of the solvency of insurance companies;
- the application of the antitrust laws to the business of insurance does not constitute "regulation" of the business of insurance.

Mr. Chairman, sometimes it is important to testify regarding important issues even if it means that strongly held beliefs must be challenged. There is no doubt that the McCarran-Ferguson Act has come to have a mystical and ideological meaning that is greater than its legal and economic importance. My testimony is not against the insurance industry, but in favor of competition. very substantial economic and social interests in American society, and I would not take the position I am taking today if I thought the application of the antitrust laws to the business of insurance would harm this industry's long-term, vital interests.

BACKGROUND

Mr. Chairman, I will try to make my point of view as clear as possible throughout my testimony. One point I want to be clear about is that I do not believe that the insurance industry has engaged in any conspiracy to fix the price of insurance policies. In my opinion, the insurance industry has, in general, been very responsive to market forces. The pricing of property casualty insurance is set largely -- in many markets and states -- by market forces. Similarly, I do not think that any conspiracy or agreement among insurance executives caused the liability insurance crisis.

The insurance industry, of course, is not blameless. Cash flow underwriting (or the lack of any underwriting at all), and the failure to stick to basics in exercising appropriate financial discipline, exacerbated a situation created by outside economic forces. Those forces included: dramatic increases in interest rates in the late 1970's followed by sharp decreases in the 1980's; dramatic changes in the terms of reinsurance contracts which forced primary insurance companies to increase rates; broader rules of tort liability; and injection of foreign capital into the business of insurance which created overcapacity and strong pressures to engage in dangerous price wars.

into the business of insurance which created overcapacity and strong pressures to engage in dangerous price wars.

Although the antitrust immunity granted to the business of insurance under the antitrust laws was not the sole or major contributing cause to the liability insurance crisis, that does not mean that it is not appropriate to reconsider this exemption and to repeal or modify it, if appropriate.

I hope that by acknowledging that this legislation did not cause and will not solve all of the problems relating to the business of insurance,[1] my position will not be construed as indicating any reservations regarding its enactment. Although, as I will indicate shortly, there are issues regarding permitted joint activity that deserve careful attention, the overall thrust of these proposals, particularly S. 804 and S. 1299, has my strong support.

I view the proposed legislation as a very serious effort to modify antitrust policy as it applies to the business of insurance. I most certainly do not support this legislative effort because I think the insurance industry should be punished for its role in the liability insurance crisis, nor do I support it as a stalking horse for floor amendments to establish federal licensing antitrust laws to the business of insurance, a recommendation made by the Department of Justice in 1976 and ratified in 1979 by the National Commission to Review the Antitrust Laws.

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[1] Although I do not see this legislation ending the insurance cycle or all other aspects of the liability insurance crisis, it will, in my opinion, permit a more penetrating analysis of what those problems really are. If a policy of competition is adopted, it may encourage states to consider removing certain regulations that add costs and administrative friction to insurance transactions which in turn make insurers reluctant to participate in certain markets.

THE INSURANCE INDUSTRY IS COMPETITIVE

I will not recite in any detail all of the overwhelming evidence that demonstrates that the insurance industry as a whole, and the property-casualty insurance industry in particular, has a competitive structure and operates in accordance with competitive market forces. But, its worth noting that the two authoritative studies of competition in the insurance industry indicate a consensus:

> A predominate segment of the property-liability insurance industry is favorably structured for competition, with a large number of competitors, relatively moderate concentration, ease of entry, a standardized service, a relatively simple and short-term contract, and an increasingly price-sensitive consumer market. The available evidence suggests that unrestricted price competition would be an effective alternative to state rate regulation and compatible with regulatory objectives for a reliable insurance mechanism.

The Pricing and Marketing of Insurance at xi-xii (U.S. Department of Justice, January, 1977).

And the National Commission for the Review of the Antitrust Laws found:

> [The insurance industry is] [c]haracterized by a lack of significant economies of scale, relative standardized policies, and low barriers to entry, the property-liability industry appears competitively structured.

Report of the National Commission for the Review of Antitrust Laws and Procedures, 229 (1979).

Competitive Structure.

The competitive structure of the property-casualty insurance industry is demonstrated by a comparison of the market share ratios for the top four companies in several major lines of property-casualty insurance with the four firm concentration ratios in selected areas of manufacturing

TABLE 1*

Market	Market Share
Insurance	
Private passenger auto	38.4%
Commercial auto	17.2%
Homeowners	36.1%
Manufacturing	
Soft Drinks	15.0%
Greeting Cards	80.0%
Cement	32.0%
Primary Aluminum	67.0%

* Sources: Best's Executive Data Service (1985 Direct Written Premiums); Manufacturing Market Share Data from the Department of Commerce (Business and Industry Outlook 1982).

markets in this business are competitive, it should be exempt from the antitrust laws. This is a novel argument, but it has no merit. Can you imagine a group of car dealers from Tysons Corner or the entire Washington, D.C. area coming to Congress and seeking an exemption from the antitrust laws because their business is very competitive? If the existence of "workable competition" was a justification for an exemption from the antitrust laws, a large segment of the American economy would be exempt. This would be obviously unacceptable and would give rise to wholesale price fixing and other market constraints that the antitrust laws are intended to prohibit and punish.

If there is any justification for an antitrust exemption, it cannot be that the industry is competitive, it must be something else.

Unique Characteristics of Insurance Contracts: The Need to Share Loss Data.

The justification for an antitrust exemption for the business of insurance is based on the need of insurance companies, particularly small companies, to determine the average expected loss cost[1] for a particular class within a particular line of insurance. As stated explicitly in the legislative history of the insurance. As stated explicitly in the legislative history of the McCarran-Ferguson Act:

> The theory of insurance is the distribution of risk according to hazard, experience, and the law of averages. These factors are not within the control of insuring companies in the sense that the producer or manufacturer may control cost factors.

H.R. Rep. No. 873, 78th Cong., 1st Sess. 8-9 (1943), quoted in Group Life & Health v. Royal Drug, 440 U.S. at 202, 221 (1979).

It follows, that if the rationale for the antitrust exemption is to permit the sharing of loss data which is necessary to establish statistically valid information about average loss costs for various lines and classes of insurance, then the antitrust immunity should be limited to activities that are necessary and proper to accomplishing that end.[2] Both of the bills, S. 804 and S. 1299, adopt this approach although they differ with respect to the number of activities that are explicitly exempt, and the extent to which loss data can be adjusted to reflect average expected loss costs in the future.

Once you accept the premise that the collection and dissemination of loss information should be permissible, it logically follows that a bureau or statistical agency must develop some type commercial automobile liability insurance from private passenger automobile liability insurance. For example, how are claims arising out of the use of rental cars treated? Again, although the answer is probably obvious, guidelines are needed to assure that all insurance companies report their loss data in a uniform manner. That is the only way to assure that the statistical data will be useful in establishing average expected loss costs for a particular class of insurance.

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[1] I use the term average expected loss cost because it is easier to understand than the insurance industry term "pure premium rate." I include in the meaning of the term "average expected loss cost" the sum of the average expected claims payments per policyholder and the average expected allocated loss adjustment expense per policyholder. This is the amount which must be earned from premiums received and set aside to pay future claims.

[2] For purposes of clarifying permitted joint activity, S. 804 also lists certain activities similar to those that are carried out by trade associations on behalf of their members.

The Need to Adjust Loss Data to Reflect Current or Future Costs.

It is also my opinion that insurers should be permitted to adjust data regarding past losses to reflect current, and perhaps future, costs. I am aware of Senator Metzenbaum's concern about the potential danger of an industry dominated rate bureau influencing pricing through its action with respect to developing average loss costs, or pure premium rates. I would note that there is less danger if a rate bureau operates independent of its subscribers. I understand that the Insurance Services Office (ISO) has from time to time excluded company officers from rating decisions related to rate schedules in "open competition" states.

Let me return to the reason why I think insurers should be permitted to modify the raw numbers concerning past losses to reflect current costs. I should note that I am not an actuary and I will not explain or defend the details of ISO's current methodology regarding loss development or trending. Nothwithstanding that caveat, I think all of us can appreciate the fact that insurance losses and claims settlements occur over a period of time.

I will not explain or defend the details of ISO's current methodology regarding loss development or trending. Nothwithstanding that caveat, I think all of us can appreciate the fact that insurance losses and claims settlements occur over a period of time.

Moreover, it is not uncommon in various lines of insurance, or at least within particular classes of insurance, to experience a variation in the claims rate. I see no harm, and frankly see substantial economic efficiencies, in permitting a rating service, using reasonably established statistical methodology and recognized economic indicators, to bring average past loss costs up to current costs.

I also see no reason why a rating service should not be permitted to adjust the average expected loss to reflect changes in the average claims rate (the claims rate is the expected number of claims per thousand insured units). For example, if the claims rate had gone from ten per thousand to 20 per thousand and then jumped to 50 per thousand and 80 per thousand over the course of four years, it seems to me totally logical to reflect this increasing claims rate in the determination of the average expected loss cost.

Whether a rating service should be permitted to project future average loss costs, raises additional questions. Perhaps the answer should turn in part on whether the rating service is a rate bureau controlled by member insurance companies rather than an independent organization. Perhaps it should also depend on the extent to which subjective judgments about future average claims benefits in promoting greater competition. In most property-casualty insurance lines, the average "expense component" is somewhere between 25 and 40 percent of the total premium. Therefore, even if all companies use the same "pure premium rate" (the sum of the average loss costs plus the average allocated loss adjustment expenses) -- which is not very likely -- there still will be extensive competition among companies. Companies with lower marketing and commission expenses, lower overhead, and lower underwriting profit margins built into their rates can actually offer lower premiums in the markets. In fact, this is exactly what has occurred in automobile insurance over the past 25 years, and it is occurring in other lines of insurance as well. In my opinion, substantial price competition would occur even if a rate bureau projected future average loss costs, although I appreciate the views expressed in the 1976 Department of Justice Study that any such projection should be done by an independant statistical organization.

Other Joint Activities.

I will touch only briefly on other joint activities that should, perhaps, be explicitly authorized by the insurance antitrust laws. S. 804 permits making inspections for the purpose of rate classification, collecting statistics relating to causes or prevention of losses, conducting research and inspections in order to prepare classifications for public fire defenses, conducting research to determine the impact of benefit level changes on pure premium rates, distributing information relating to fraudulent rate classification, collecting statistics relating to causes or prevention of losses, conducting research and inspections in order to prepare classifications for public fire defenses, conducting research to determine the impact of benefit level changes on pure premium rates, distributing information relating to fraudulent claims, and distributing current prices of insurers, if that information is made available to the general public. See S. 804, proposed Section 3(b)(7)-(12). Some of these activities are also covered in Senator Metzenbaum's bill. See S. 1299, proposed Section 3(b)(3) and (4). These activities are generally consistent with the type of activities trade associations are permitted to engage in under the antitrust laws, even in the absence of any explicit statutory authority. It may be useful to consider including these provisions in any insurance antitrust legislation if only to overcome the overwhelming fear in the insurance industry that all of these activities would be prohibited, if the antitrust laws applied to this business.

The Joint Activities That Are Permitted Under the Antitrust Laws Should Not be Limited to Activities That Are Reviewed or Approved by State Insurance Commissioners.

In my view, if the antitrust laws apply to the business of insurance, those laws should explicitly permit insurers to engage in certain limited and necessary joint activities. It is unnecessary to condition the permission to engage in these activities on their review or approval by state insurance commissioners. If the premise of this legislation is that although insurance markets are competitive, the unique nature of the insurance contract makes it McCarran-Ferguson Act, states would not be required to regulate insurance rates in order to make this limited joint activity lawful.

Preemption of State Rate Regulation.

As I have indicated, I strongly endorse the thrust of the proposed legislation which encourages competition and lets the market set the price for insurance products. To assure that the policy of these bills is successfully carried out, the legislation should preempt and take away state authority to regulate insurance rates.

If a preemption provision is not included in the bills, then nothing will prevent the States from either authorizing or requiring the very kind of collective rate-making and price-fixing which the bills intend to discourage and should prohibit. That result may occur because in Southern Motor Carriers Rate Conference, Inc. v. United States, 471 U.S. 48 (1985), the Supreme Court held that the activities of motor carrier "rate bureaus" which submitted, on behalf of their members, joint rate proposals to state public service commissions under state laws that authorized but did not compel collective rate-making, did not violate the antitrust laws of the United States. The Court held that this conduct was immune from the Federal antitrust laws by virtue of the "state action" doctrine announced in Parker v. Brown, 317 U.S. 341 (1943). The Court said that as long as the action of a private party can be attributed to a "clearly articulated state policy," it does not violate the antitrust laws. In Southern Motor Carriers, the Court from the Federal antitrust laws by virtue of the "state action" doctrine announced in Parker v. Brown, 317 U.S. 341 (1943). The Court said that as long as the action of a private party can be attributed to a "clearly articulated state policy," it does not violate the antitrust laws. In Southern Motor Carriers, the Court found that the statutes of several states expressly permitted collective rate-making.

Many state insurance laws are similar to the motor carrier laws which provided antitrust immunity in Southern Motor Carriers. Therefore, unless preemption of state rate-making authority is included in the insurance antitrust legislation, its impact on the conduct of insurance rate bureaus and insurance companies is uncertain. It would be an important symbolic statement in favor of competition, but it would not require the companies to compete with respect to their final prices or rates. Moreover, it could lead to increased regulation of insurance rates by states seeking to assure that they maintain their authority. In sum, removing the antitrust immunity provided to the insurance industry under the McCarran-Ferguson Act, will not by itself assure that the Federal antitrust laws are applicable to insurance rate bureaus. In order to accomplish that goal Congress must also prohibit States from authorizing insurance companies to engage in collective ratemaking activities.

For all of these reasons it is appropriate to preempt state authority to either authorize insurance rate bureaus or permit states to affirmatively regulate liability insurance rates. I have enclosed a draft provision (Exhibit A) that would accomplish mobile insurance, etc.

* * *

With regard to the argument that limiting the power of states to "regulate" insurance rates will cause a greater tendency for insolvencies (a possible argument against preemption of state rate regulation), there are several responses. First, notwithstanding rate regulation, there have been several dozen insolvencies in the last three years. Second, state-by-state rate regulation cannot prevent insolvencies if a rate war occurs. That is so because even if the insurance commissioners in a significant number of states prohibit rate reductions, if insurance commissioners in other states allow substantially underpriced policies to be sold, that will still cause the insolvency of a company. (The premiums earned on all policies in all states go into a pool to pay all claims arising in all states in which claims arise. Even if adequate premiums are charged in a number of states, if the premiums are inadequate in many other states, there will be a shortage in the pool of reserves and an insolvency will occur.)

The only effective means for reducing insurance insolvencies is adopting uniform and adequate accounting rules, conducting regular and rigorous examinations, and establishing and enforcing rules to assure that liability insurance coverages, as well as health, life and other coverages, are adequately reserved to pay future claims. Seeking to achieve that goal by regulating insurance rates state-by-state is illusory. There are many different lines of insurance and hundreds of classes within those lines. It rules to assure that liability insurance coverages, as well as health, life and other coverages, are adequately reserved to pay future claims. Seeking to achieve that goal by regulating insurance rates state-by-state is illusory. There are many different lines of insurance and hundreds of classes within those lines. It is far more sensible to focus on the assets and reserves of a company than on its rates (in 50 different states) to assure the company's solvency.

* * *

Pooling and Joint Underwriting of Risks Should be Permitted.

Reserve requirements and prudent management dictate that substantial risks should not be accepted in their entirety by a single insurance company. Instead, pools, joint underwriting, and reinsurance are used to distribute and share risks. Even in the absence of any explicit statutory exemption, it is likely that these arrangements would be treated as a "joint venture" for the purposes of the antitrust laws. Under standard joint venture analysis, competing firms may join in order to undertake a large project if they would be unlikely to undertake the risks themselves or would have insufficient resources to undertake it individually. Pooling and joint underwriting seem particularly suited to this type of analysis. The 1979 National Commission for the Review of Antitrust Laws and Procedures concluded that there appeared to be no reason why traditional joint venture analysis would not apply to insurance pools and joint underwriting.

It is worth noting that the antitrust laws have been applicable to aviation insurance for more than 25 years. In re Aviation Insurance Industry, 183 F. Supp. 374 (S.D.N.Y. 1960). In addition, many states exclude aviation insurance from their ratemaking requirements or the entire insurance code. The argument that pooling and joint underwriting cannot be conducted within the antitrust laws is, therefore, without merit. Moreover, pooling and joint underwriting are expressly authorized by S. 804 and S. 1299.

Application of the Antitrust Laws does not Constitute Federal "Regulation" of the Business of Insurance.

Some witnesses appear to have characterized legislation to apply the antitrust laws to the business of insurance as constituting federal regulation of that business. I think those characterizations are wrong, unless they refer solely to the proposal to extend the FTC's authority over unfair acts or practices to the business of insurance. Many of those remarks were made in connection with S. 80, which would have repealed the McCarran-Ferguson Act completely. But even with respect to that bill, the argument is incorrect. Modification of the antitrust immunity of insurance companies will not by itself create any federal regulatory agency that will license or "regulate" insurance companies.

Application of the Antitrust Laws to the Business of Insurance Will Not Hinder Legitimate State Regulatory Authority.

Even if the antitrust laws apply to the business of insurance, that will not diminish the authority of states to license insurance companies and insurance agents. Nor will it impair the authority of states to conduct examinations of the financial condition of insurance companies. In sum, state insurance departments will continue to maintain licensing authority and the power to regulate the solvency of insurance companies as well as the insurance companies and insurance agents. Nor will it impair the authority of states to conduct examinations of the financial condition of insurance companies. In sum, state insurance departments will continue to maintain licensing authority and the power to regulate the solvency of insurance companies as well as the marketing conduct of companies and their agents. That authority is unaffected by the pending legislation.

Application of the Antitrust Laws Will Not Necessarily Create More Uncertainty or Litigation.

Some critics of the pending bills have argued that application of the antitrust laws will create substantial uncertainty and litigation. First, a lot of that criticism is directed at S. 80, and it is not applicable to the new bills which clearly spell out permitted joint activity. Second, a recent Lexis check of

McCarran Act citations in the Federal courts since 1970, indicated that there are 167 reported cases dealing with McCarran and antitrust immunity since 1970. Currently insurance antitrust litigation is complex because the courts must decide if the activity constitutes the "business of insurance" and if that activity is "regulated by state law." The issue of whether the antitrust laws apply arises only after answering those two highly litigated questions.

In my opinion, providing a general rule that the antitrust laws apply, and providing an exemption for certain limited but clearly defined activities, will not cause confusion and uncertainty and will not result in undue litigation about the application of the antitrust laws. Moreover, the Department of Justice has a formal process of issuing "business review letters" regarding proposed company or trade association activities. This method could be used to resolve particular questions about permitted joint activity, including technical questions regarding the operations of a rate bureau.

Application of the Antitrust Laws Would Not Impair State Guaranty Funds or Voluntary Action to Assist Policyholders in the Event of an Insolvency.

It has been suggested that application of the antitrust laws to the business of insurance might impair state guaranty funds that protect policyholders in the case of an insolvency or interfere with the voluntary action to assist policyholders in the case of an insolvency. It is unclear how the activities of a guaranty association would be construed to violate the antitrust laws or why their activities would not remain immune from liability under the state action doctrine. The same is true with respect to the voluntary action of insurance companies in connection with the Baldwin-United bankruptcy. Although the insurance companies participated on a voluntary basis in developing a policyholder fund, this action was done, to some extent, in place of action that would have been required under state guaranty fund laws. Moreover, the voluntary plan was overseen and approved by the courts before whom the bankruptcy was pending. Therefore, I do not see this as a serious issue. But even if I am wrong, the response should be an appropriately crafted exemption, not a complete rejection of the application of the antitrust laws.

CONCLUSION

Mr. Chairman, as I said at the outset of my testimony, I favor the application of the antitrust laws to the business of insurance. I take this position because I think it represents sound policy, it is consistent with our overall national policy of promoting competition and open markets, and I do not think it will hinder any legitimate interest or activity of the insurance industry.

I appreciate the opportunity to present my views to the Committee and I will be pleased to answer any questions of you or any other members of the Committee.

EXHIBIT A

PREEMPTION OF STATE RATE REGULATION

(f) Notwithstanding any other provision of law, except to the extent provided in subsection (g),[1] no State shall enact or enforce any law, order, rule, regulation, standard, or other policy of government having the force and effect of law requiring approval of rates or policy forms for any property or casualty insurance, except a policy form for personal risk insurance.

As used in this subsection "personal risk insurance" means homeowners, tenants, private passenger non-fleet automobile, mobile home, and other property and casualty insurance primarily for personal, family, or household needs.

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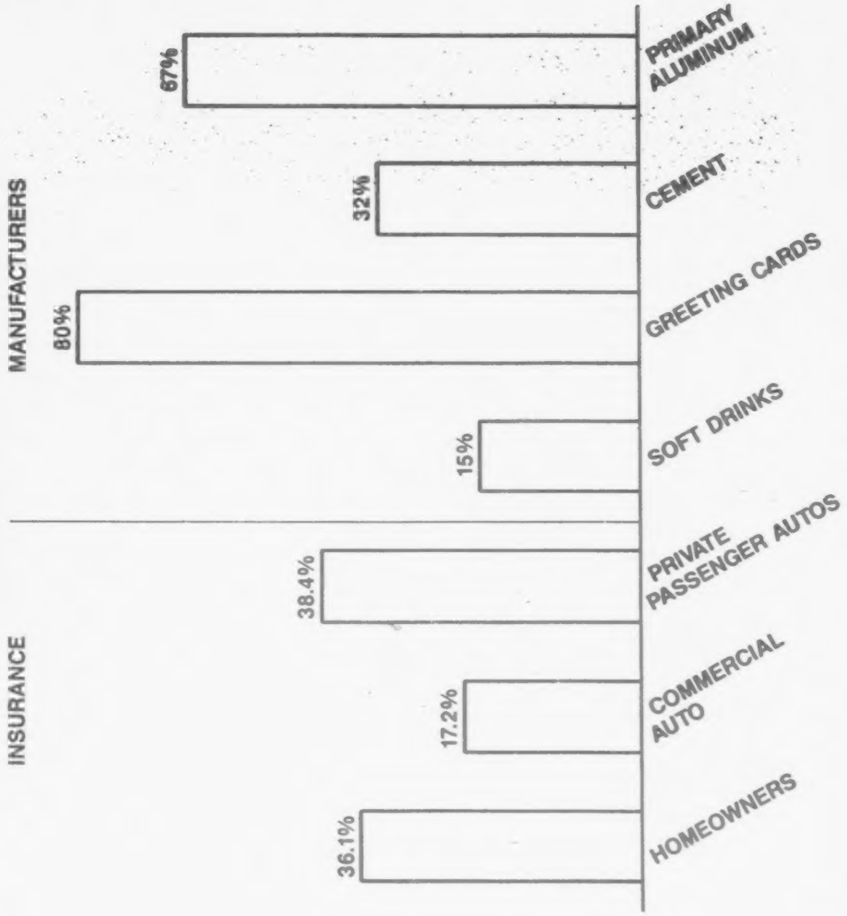
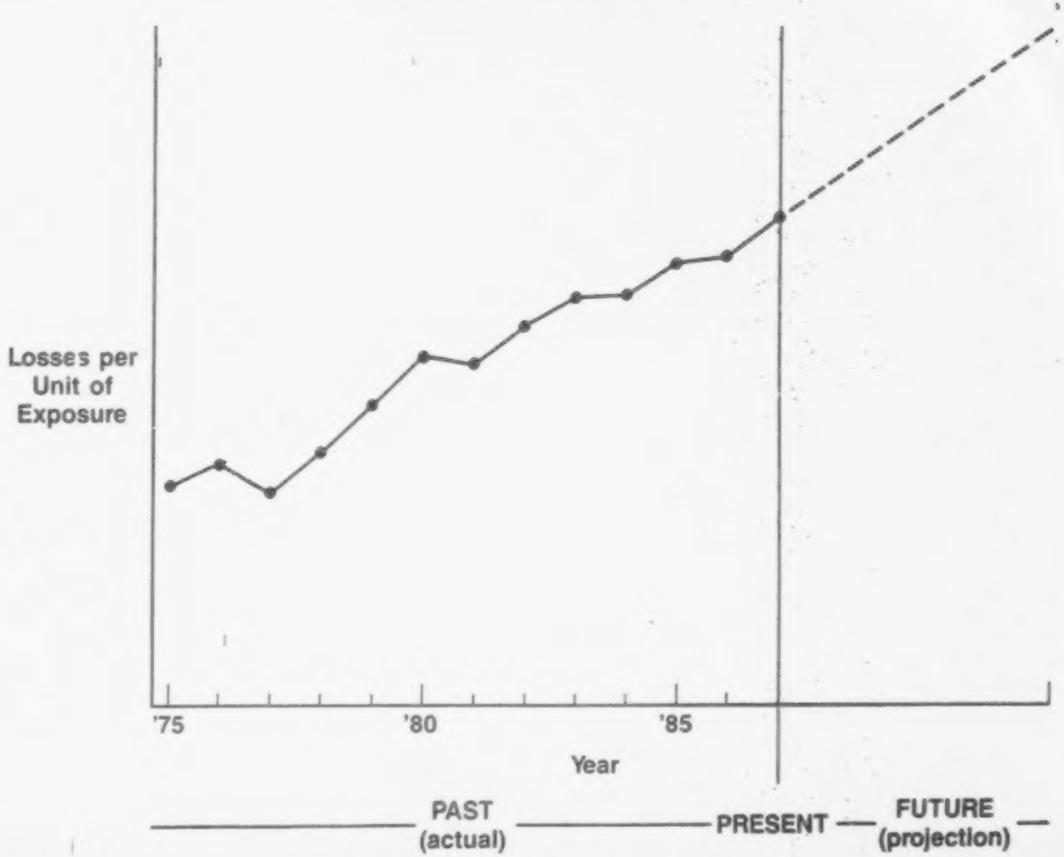
[1] Subsection (g) permits a State to require insurers to use a uniform classification system for establishing rates for workers' compensation insurance.

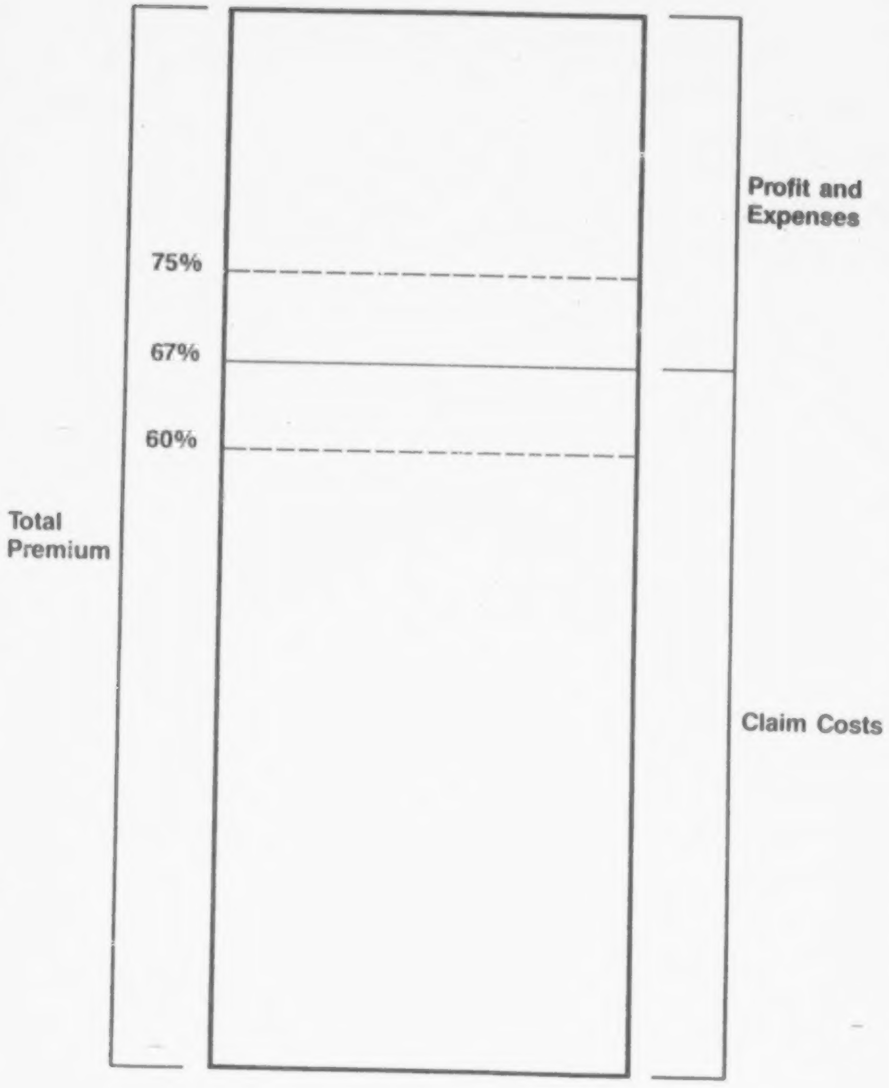
COMBINED MARKET SHARES OF FOUR TOP FIRMS



LOSS TRENDS


Losses per Unit of Exposure
'75
'80
'85
Year
PAST (actual)
PRESENT
FUTURE (projection)

PREMIUM BREAKDOWN


Profit and Expenses
75%
67%
60%
Total Premium
Claim Costs

Senator **Metzenbaum**. Thank you, Mr. Mullen.

Mr. Jones, you are a man of vast experience in the insurance industry, and I must say we are particularly pleased to have you here testifying today. You were President of the American Insurance Association for 19 years, and certainly nobody can question the fact that you are thoroughly dedicated to the welfare of the industry. You gave much of your life to it.

You say in your prepared statement that, "One wonders if McCarran-Ferguson has not served its purposes." You also say that, "The time and opportunity has come for the insurance industry to rid itself of the negative public and official attitudes stemming from McCarran-Ferguson. The insurance industry would be wise to seize this opportunity and work with the committee to redefine the relationship of the Federal antitrust laws to the industry and State regulation."

To me, that means that you would not oppose repealing the insurance industry's current broad exemptions from the Federal antitrust laws.

Mr. **Jones**. No, I would not oppose your bill, sir. I do urge you to work with the industry and see if there are other joint activities that they can prove to you would not be anti-competitive and would be help the industry meet its needs.

Senator **Metzenbaum**. Mr. Jones, I want you to know that we would be delighted to work with the industry. We would be delighted to work with you or anybody else in the industry. We have no desire to do harm to the industry.

We want to make the industry the most important economic industry in all of America, to participate fully in the free competitive processes of this country and in the free enterprise system, and we are happy to work with them.

I must confess, and my questions to Mr. Matschulat will perhaps emphasize that point, that I am not sure that the industry is anxious to sit down and try to make some positive progress. I think they are more interested in putting out misleading propaganda.

Mr. Matschulat, you say in your prepared statement that the aim of many proponents of this legislation is not continued State regulation, but Federal regulation. Now, my new bill states in the clearest possible terms that the "continued regulation and taxation by the several States of the business of insurance is in the public interest."

I do not know how I could be clearer than that. You and your colleagues continue to spread the myth that I am against State regulation. Your McCarran lobbying group's name is, on its face, a fraud because you call it The Coalition for State Regulation of Insurance.

Why do you insist on saying that the continued State regulation is not an aim of this legislation when that statement simply is not true? I do not understand you.

Mr. **Matschulat**. Mr. Chairman, let me see if I can clarify my point of view. I think that without any question, you are absolutely right. I do see the bill as being intrusive with respect to Federal regulation. I see it as a practical outcome of what the bill proposes.

I guess it stems from my understanding of the way the world works. I think it is very difficult to draft in language, no matter how well wordsmithed and crafted, the practices of an industry so intricate and evolutionary in nature and so complex as the property casualty insurance business.

Senator **Metzenbaum**. What is so complicated about your business? You put in so many dollars, you say this is what the loss ratio is, you have certain amounts for taxes, you have certain amounts you pay for overhead.

Mr. **Matschulat**. We have got a lot more for taxes.

Senator **Metzenbaum**. You are not any more complicated—this man and I worked to draft legislation having to do with the computer industry so that that industry might work together, and it is far more complicated and probably far less familiar to people such as we than is the insurance industry. Yet, you come here and tell us how complicated it is.

Tell us why you keep talking about State regulation when we say you have got State regulation and you are going to keep it.

Mr. **Matschulat**. Well, let me perhaps speak in terms of an example. I am in doubt as to how the involuntary market mechanisms would work.

Senator **Metzenbaum**. About what?

Mr. **Matschulat**. The involuntary market mechanisms that each of the States have developed. I think 48 States during 1986 put into operation a market assistance plan or a joint underwriting association to help cope with the availability and affordability problem that the industry and the public faced last year.

Senator **Metzenbaum**. Is that a big problem?

Mr. **Matschulat**. These are involuntary market mechanisms. In other words, they are devices for helping consumers find willing insurance companies. These are MAPS, or market assistance plans.

Senator **Metzenbaum**. Is that one of the major problems you have with our bill?

Mr. **Matschulat**. It is certainly an issue. How would that work?

Senator **Metzenbaum**. That is covered and my bill will permit that to continue. Let us go on to the next problem you have. It specifically says you can do that. Read the bill.

Mr. **Matschulat**. Well, I am thinking in terms of how it would work. I think my fear is that on that issue and on a host of other issues, resolving how, in fact, it would actually work would involve us in costly, unproductive litigation. We would spend years in the courts, and under the full brunt of the antitrust laws it would have a chilling effect on competition. It would be anti-competitive in a significant way.

There is no reason why we would step up to the plate and volunteer our participation to help solve market problems in the face of antitrust threats.

Senator **Metzenbaum**. Mr. Matschulat, I read your prepared statement and wonder, again, whether you have even read the bill, which was circulated in the industry for weeks before it was introduced last Friday.

We have tried every way possible to get the industry in to tell us what language you need. Tell us what will make it operable. We are not trying to affect the industry and its normal business practices, provided they are not anti-competitive.

But you say amendment of McCarran will produce "uncertainty about what joint activities are permitted, including loss data pooling and policy form preparation." Yet, my bill expressly clarifies that those activities would be lawful.

You also question whether your company could continue to participate in joint underwriting pools and market assistance plans. Yet, again, my bill specifically allows these activities.

As a matter of fact, you have not named one essential joint activity that you would not be able to engage in under my bill, and I would say to you, Mr. Matschulat, send the message back to your industry that if they want to work to draft a bill to take care of legitimate business concerns, this Senator, who is the author of the bill, is prepared to work with them.

But to just go out and form a committee that has got an absurd name, a fraudulent name, to be specific, because you talk about preserving State regulation and I am already saying we are going to preserve that—but if they really want to do something positive, my doors are open and we are prepared to work with you starting this afternoon.

Mr. Osborne, you mentioned that in Oregon hearings can be held if the rate is at issue. Could you tell me how often that is done in Oregon?

Mr. OSBORNE. Mr. Chairman, as I prefaced my remarks, let us revisit the three parts of the rate law again. Rates will not be excessive, they will not be inadequate, and they will not be unfairly discriminatory.

Through the environment we have just been through, actually, little policing is going on when rates drop. That is not a popular thing to do. Rates are only policed when they go up.

I think there is evidence that there is a need at the State level to police rates, particularly in this environment, and I have no objection to that, sir, because we are doing it within our own environment and we are doing it within the environment of our own State laws within the States.

Hearing processes, yes, sir, have been heard and have been conducted, and I perceive that hearings will be heard and judged whether they are fair or unfair or whether they comply to those basic criteria, sir.

Senator METZENBAUM. Mr. Osborne, you are Chairman of the National Association of Mutual Insurance Companies, as well as Chairman and Chief Executive Officer of your own company.

Mr. OSBORNE. Correct, sir.

Senator METZENBAUM. Would your organization be receptive to working with the committee to try to draft language which would have to do with the special concerns or problems that you might have if the bill is passed, or is the position of the organization so diametrically opposed to repeal of the antitrust exemption that you would be unwilling to sit down with us?

Mr. OSBORNE. Well, sir, our association always is available to sit down with government to work these things out for the common cause. I might suggest that I do not represent a committee. I represent 1,300 companies and a lot of these are small people.

When we conducted our survey, we had a little over 45-percent response, sir, which, for us, was the highest rate of response on any questionnaire that we had sent out, and I felt in reviewing that that they were fairly unanimous. Some are highly sophisticated, some are not, but I think they joined together and I think the figures show that they did not feel that McCarran-Ferguson was really what got us to this point, this point being the competition restriction and some of those things.

They did feel for their own survival that pooling of figures was necessary, but not just loss figures either. We should be able to compare expense figures. We should be able to compare incurred-but-not-reported, and that, sir, is just for losses that have occurred within an accounting period but that we do not know anything about.

We also need to compare allocated loss adjustment expense. I can tell you today, Senator Metzenbaum, that the variances State-by-State on loss adjustment expense are just absolutely horrendous, and we need to have a facility to blend those into our figures too, sir.

Senator **Metzenbaum**. Well, our doors are open to you and if the mutual insurance companies care to sit down with us, we would be very happy to see if we can work with you to make some positive steps along the line. We have done that with many other pieces of legislation around here when the industry was willing to come in—industry, labor, whatever the case may be—and have been able to work out legislation. I would urge it upon you.

Mr. **Osborne**. Thank you very much.

Senator **Metzenbaum**. I have a couple of questions for Mr. Mullen and then——

Senator **Thurmond**. Mr. Chairman?

Senator **Metzenbaum**. I yield to you, sir.

Senator **Thurmond**. Senator Metzenbaum and I are frequently at odds with each other, but we have gotten together on some things and I think we have come up with some good legislation. I am not too sure we will be together here, but it is possible that something could be done.

I was thinking this: If the author of the bill and a representative of the Justice Department and a representative of the insurance industry and maybe Mr. Jones and any staff from the committee who wants to meet with you all—if you could have a meeting, it is possible you might get together and solve this thing.

Senator **Metzenbaum**. I would be very happy to, very happy to.

Senator **Thurmond**. That would bring in the different elements, the Justice Department, the insurance industry, the author of the bill, and any others that want to meet. If I do not meet, I could have my staff member meet.

In other words, I have found frequently that people have misunderstandings about things. If you can sit down face-to-face, you can go back and forth, explain things and get agreement. It may take a little time, but if it takes a whole day to do this, it might be worthwhile to the insurance companies and Justice and the public and all concerned.

What would you think of that?

Senator **Metzenbaum**. Mr. Matschulat.

Mr. **Matschulat**. You know, I think that searching for a common ground where there is mutual agreement that there is a problem makes good sense, Senator, but I fail to see where the problem is. What is the problem that we are going to agree to solve?

My company, as I pointed out earlier, has thrived in this current competitive environment.

Senator **METZENBAUM**. How about the policyholders? Have they thrived?

Mr. **MATSCHULAT**. We do not coerce——

Senator **METZENBAUM**. You do not care about them.

Mr. **MATSCHULAT**. The reason why we have grown as we have grown is that we were selected by the public over other insurance companies based on the quality of our service and on its price.

Senator **METZENBAUM**. Well, Mr. Matschulat, there is obviously a problem.

Mr. **MATSCHULAT**. It is a competitive environment. It is not a problem.

Senator **METZENBAUM**. There is a problem because the Senate is moving on a piece of legislation. That is the problem, if nothing else. But the real problem is there is no competition in this industry.

Mr. **MATSCHULAT**. That is absolutely untrue.

Senator **METZENBAUM**. Well, you may say so, but the question that the Senator asked you is whether or not the industry would be willing to sit down and talk. Mr. Osborne has indicated that they would be willing, as I understand it, to sit down and discuss the matter. I know that the Justice Department would be willing to do so.

But it is pretty hard to dance with yourself, and——

Senator **THURMOND**. I am not sure you will be able to get together, but I think the effort would be worthwhile. I think to make the effort would be worthwhile.

Mr. **MATSCHULAT**. Well, the industry is intensively competitive. I mean, we have just seen it in technicolor at the end of the table. This is a very competitive industry. My own personal experience is that it is a very intensely competitive industry.

Competition is based on quality of service and on price, so what is the problem? Where is the problem that we are gathering in this meeting to solve? It seems to me that what we have here is a solution in search of a problem.

Senator **THURMOND**. I do not want to see the insurance companies hurt. At the same time, there is a perception that possibly something does need to be done. Now, he has got this legislation and it may pass if you do not see if you can correct it. The Democrats are in the majority. He has got three or four Democratic Senators as authors here of this bill.

I want to see that what is done is right and protects the public and at the same time protects the insurance companies, and I would be hopeful that you would sit down and see what you can do that will not hurt the companies and at the same time remove any perception that exists.

Mr. **MATSCHULAT**. Well, I cannot imagine that we would vote such a major piece of legislation to change the competitive structure of a well-functioning industry based on perceptions.

Senator **Thurmond**. Well, I have just made a suggestion. [Laughter.]

You do not have to follow it. You may be hurt if you do not, though. [Laughter.]

I am trying to look after you the best I can, but I want to be fair now to all concerned, and I suggest you see if you can get together and come up with a piece of legislation because he is like a bull dog; he is going to press it. [Laughter.]

Senator **Metzenbaum**. I am even going to get Thurmond on my side if I try and try and try.

Senator **Thurmond**. Well, I may have to oppose him. I may have to oppose him when you come up and see if you can reach an agreement.

Mr. **Matschulat**. Senator, with all due respect, I believe that the public is being served well now.

Senator **Thurmond**. But a lot of people do not think so.

Mr. **Matschulat**. No human system is perfect. It seems to me that the current system——

Senator **Thurmond**. I have found this the longer I serve the public: There are more views than one. Now, that is your view, but there may be other views. I want to see that what is done is right for the public, right for the insurance companies.

I realize there are some people who are zealots; they will go too far. At the same time, I think it is to the advantage of all concerned here if you can sit down and make an effort. You may not agree. Then you can come back.

As far as I am concerned, I may agree or disagree with what is done, but I would like to see an effort made, and I think you are making a mistake if you do not make the effort. Now, that is my view.

Senator **Metzenbaum**. I want to share with my colleague that we will try to set up such a meeting.

Mr. **Jones**. Senator Thurmond and Mr. Chairman, I want to agree with Mr. Matschulat that the consumer is being served well and there is a lot of competition out there. From my perspective, the issue is public relations, the public attitude about this exemption.

The public thinks it is a broader exemption than the industry ever thought. Every time the Supreme Court speaks, it narrows this concept of "the business of insurance" as used in that law. It is much narrower than even we thought in the industry.

So this public perception is an onus that the industry has carried that I think it has an opportunity here to rid itself. There is tremendous competition out there. The limited exemption is not the problem that gave rise to the liability insurance crisis. That set of problems should be addressed separately.

Senator **Thurmond**. Mr. Jones, you have had a lot of experience representing insurance companies.

Mr. **Jones**. Yes, sir.

Senator **Thurmond**. It would not hurt if you would meet with this group.

Mr. **Jones**. I would be happy——

Senator **Thurmond**. You seem to strike me as being unbiased and fair-minded on this and you may have some thoughts that would be very helpful. As I say, I do not know what you could come up with and I may not agree with it because I am going to see that the insurance companies, as best I can, are protected.

At the same time, I think there is a possibility here to accomplish something if you all get together.

Mr. JONES. I would be happy to. I will not be in a representative capacity again, but I will be——

Senator THURMOND. I do not know whether they will pay you or not, but you will render a great service if you can meet with them. [Laughter.]

Senator METZENBAUM. Senator Grassley, did you have any questions, sir?

Senator GRASSLEY. Not of this panel, Mr. Chairman. Thank you very much.

Senator METZENBAUM. Were you trying to be recognized, Mr. Osborne?

Mr. OSBORNE. If I might, could I make a brief comment, Senator?

Senator METZENBAUM. Absolutely.

Mr. OSBORNE. You know, I have been in this business with my company for 35 years, and most of that time, sir, has been in marketing. So I think I can speak accurately that there is competition; there is a lot of it.

I might also bring the committee up to date. As late as 90 days ago, I visited approximately 50 of our Oregon agents throughout the whole State and one thing they were saying that was in common is there is a great deal of competition going on today.

One of the problems that I have with this proposed legislation, sir, is the premise that it is not competitive. The reverse is true. This morning, you were commenting on your frustration, sir, and those people with you, their frustrations, and I have had my frustrations.

I can share with you that the last 2 or 3 years have been the most devastating in the 93-year history of our company, sir. But let me just conclude this thought with one other comment.

When I look back historically, when I started in 1952 we wrote fire, extended coverage and vandalism. That is all we wrote, and I have personally witnessed all through that time, sir, the evolution of this business.

It is my perception that the American public today is better protected than any other country in the world by far, and I say that most sincerely. I am a veteran of being out there in the marketplace. I think I can interpret that to you accurately.

The premise that we are not competitive, respectfully, sir, is not true. Thank you.

Senator METZENBAUM. Thank you, Mr. Osborne, and let us say that the premise is that no one industry in all of America should be exempt from the laws that are applicable to all of the other industries in America? I think that is a matter of concern.

Let me not overlook the fact that the insurance industry has been pretty good in coming to the Congress, as well as the State legislatures, and asking for special treatment as far as the rights of people to maintain actions in court. We had such legislation last time and if some of us had not seen fit to oppose it, it probably would have passed.

But I think that what we are really talking about here is this special exemption that went into the law 40-some years ago. I happen to remember when it happened and the details about it when it came to Ohio.

But we are prepared to try to work on a positive basis. We are not looking to throw any rocks or to be negative about the insurance industry, for which we have respect. We just think that we also have respect for the antitrust laws and think they ought to be equally applicable to all people.

The hour is now 10 minutes to 12 and I have four more people from whom we expect to hear. I want to thank this panel for their helpfulness.

Mr. Mullen?

Mr. **Mullen**. Could I just take 30 seconds? Mr. Chairman, I would just like to call your attention to a recent study by Dr. Kathleen Carlson on competition in Illinois. We have had this testimony about how difficult it would be to live under the antitrust laws.

Illinois 10 years ago abolished the rate regulation, and this study concluded that commercial insurance buyers saved $475 million over 10 years in premiums. So I think the industry could live under the antitrust laws and at least in some cases there are going to be consumer savings.

Senator **Metzenbaum**. Thank you all very much and we will look forward to working with you.

Senator **Thurmond**. Mr. Matschulat, you have got a good lawyer sitting there by you. I am sure he could work with that crowd. [Laughter.]

Senator **Metzenbaum**. Steve, if your fees do not go up 50 percent on the basis of the Senator's endorsement, I do not know why.

Our next panel, and our last panel, is Edward L. Yingling, Executive Director of Government Relations for the American Bankers Association. We are happy to have the American Bankers Association with us.

Mary Ray Oaken, President of the National Federation of Business and Professional Women's Club of the USA; Karen Knutson, Chairperson of the American Nurses' Association Council of Primary Health Care Nurse Practitioners; and Donald Randall, on behalf of the Automotive Service Association of Washington, D.C.

Now, our usual rules are 5 minutes, but we give brownie points if anybody can do it in three. Mr. Yingling, representing the American Bankers Association, we are happy to hear from you, sir, and very pleased that your organization is supportive of this legislation.

STATEMENT OF A PANEL CONSISTING OF EDWARD L. YINGLING, EXECUTIVE DIRECTOR, GOVERNMENT RELATIONS, AMERICAN BANKERS ASSOCIATION, WASHINGTON, DC; MARY RAY OAKEN, NATIONAL PRESIDENT, NATIONAL FEDERATION OF BUSINESS AND PROFESSIONAL WOMEN'S CLUBS, INC. OF THE UNITED STATES OF AMERICA, CADIZ, KY; KAREN KNUTSON, CHAIRPERSON, COUNCIL OF PRIMARY HEALTH CARE NURSE PRACTITIONERS, AMERICAN NURSES' ASSOCIATION, URBANA, IL; AND DONALD A. RANDALL, WASHINGTON REPRESENTATIVE, AUTOMOTIVE SERVICE ASSOCIATION, INC., WASHINGTON, DC

Mr. YINGLING. Thank you, Mr. Chairman. My name is Edward Yingling and I am testifying on behalf of the American Bankers Association.

The American Bankers Association supports the repeal of the antitrust exemption for the insurance industry contained in the McCarran-Ferguson Act. Our interest in this issue arises from two concerns.

First, the banking industry is increasingly in direct competition with the insurance industry and we strongly believe that industries in direct competition should be subject to the same laws, wherever that is possible.

Second, we want, quite frankly, to make a point with respect to the inconsistency of the insurance industry's use of the States' rights argument.

With respect to the first concern, I would point out to the committee that changes in technology, new consumer demands, and the increasing internationalization of the financial services marketplace have all resulted in the breakdown of traditional distinctions between the various providers of financial services.

For example, basic insurance products now compete directly with traditional banking products on both sides of the balance sheet. On the liability side, many insurance policies are now, in reality, part insurance, but part savings and investment. They compete directly with bank deposit products.

On the asset side, banks and insurance companies are in many instances making the same types of loans or purchasing the same types of bonds. Many of the major insurance companies, in fact, own banks in the form of non-bank banks or savings and loans. Thus, these insurance companies are directly in the banking business.

The banking industry is subject to the basic antitrust laws of our country. In fact, in certain instances we are subject to additional, more stringent requirements. We believe that our competitors in the insurance industry should also be subject to these same antitrust laws, laws which are fundamental to a free, competitive economy.

In other words, Mr. Chairman, legislation in this area is important to ensure competitive equity.

We agree with the testimony from the FTC in the House to the effect that a blanket exemption can no longer be justified. It seems likely that if the exemption were terminated, the current antitrust laws, particularly the State action doctrine, would permit the insurance industry to undertake any justifiable joint actions.

Nevertheless, if the Congress should determine that some exceptions from the antitrust laws are needed, specific, targeted exemptions should be narrowly crafted. This is the approach taken in S. 1299, the bill you recently introduced, Mr. Chairman, and we support that legislation.

I would also like, Mr. Chairman, to support Senator Thurmond's excellent suggestion of a few minutes ago.

Senator **Metzenbaum**. We would be happy to have the American Bankers group come in and sit in with us on those meetings.

Mr. **Yingling**. If we have anything to add to the meeting, we will be glad to sit in.

Let me now turn to our second point. We are aware that the insurance industry is resisting any modification of McCarran-Ferguson based on the argument of States' rights. We only wish the insurance industry would be consistent.

We want to bring to the attention of this committee that at the same time elements of the insurance industry are arguing States' rights in this forum, they are going before the House and Senate banking committees with an unprecedented request that the Federal Government override State laws which govern the activities of State-chartered banks.

In a number of States, State-chartered banks have long been in the insurance business, providing valuable services for consumers. Other States are considered expanding the ability of State-chartered banks to offer insurance. For example, Florida and Ohio recently adopted broader laws in response to the insurance crisis.

Similarly, New York's Governor Cuomo has recommended legislation allowing banks to offer insurance, but the insurance industry is asking Congress to preempt these and other efforts at the State level.

As our written testimony points out, banks have much to offer consumers in the insurance area, including expanded availability, lower costs, and increased convenience. A recent Consumer Federation of America study highlights these potential consumer benefits.

Given the current problems in insurance, this is hardly the time for the Congress to be telling States that they cannot permit more competition in the insurance business. Yet, that is precisely what the insurance industry is asking Congress to do.

Mr. Chairman, I will truncate my statement and just emphasize that State legislatures should be allowed to determine what their State-chartered banks can and cannot do, and we hope the Congress will reject the efforts of the insurance industry to have the Congress tell State legislatures what they can permit in this area.

[Prepared statement follows:]

STATEMENT OF

EDWARD L. YINGLING

EXECUTIVE DIRECTOR, GOVERNMENT RELATIONS

AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the Committee, my name is Edward L. Yingling, and I am Executive Director for Government Relations of the American Bankers Association. The American Bankers Association is the leading trade association representing U.S. commercial banks. The combined assets of ABA member banks comprise about 95 percent of the banking industry's total assets. Our members range in size from the smallest to the largest banks, and close to 85 percent of our members have assets of $100 million or less.

SUMMARY

In my statement today, I will make the following key points:

- The American Bankers Association supports repeal of the insurance industry's antitrust exemption. Banks and insurers directly compete in a growing range of financial activities, and we do not believe that any segment of the financial services industry should be permitted to escape from the basic rules of antitrust which ensure competition in the offering of products, as well as the pricing of products.

- Unlike insurance companies, banking organizations are subject to regulation by multiple Federal agencies and are subject to antitrust standards which equal, and in some cases exceed, the basic antitrust laws. Otherwise, the similarities between the banking and insurance businesses are far more striking than the differences.

- The insurance industry has not been a consistent defender of states' rights but has sought Federal preemption of state law and authority where its economic interests would benefit. In particular, segments of the insurance industry have come before Congress to ask that the federal government regulate the authority of state-chartered and regulated banks while at the same time arguing before this Committee, and elsewhere, that the federal government should not intrude on state regulation of insurance companies.

- Bank authority to underwrite insurance could add substantial, needed capacity to the industry. Bank authority to sell insurance could bring substantial consumer benefits in both price reduction and information availability.

- Repeal of the insurance industry's antitrust exemption would enhance that industry's economic efficiency. Industry-specific antitrust exemptions are not justifiable and sanction anti-competitive behavior. Legitimate cooperative and data-sharing activities could continue after repeal. The pressure for state regulation to meet the test of the "state action doctrine" under the antitrust laws would strengthen its effectiveness and provide the best defense against any future call for federal regulation.

* * *

Mr. Chairman, it is the position of the American Bankers Association that the McCarran-Ferguson Act should be amended so as to eliminate the insurance industry's exemption from the antitrust laws, as you have proposed in S.1299, the "Insurance Competition Improvement Act." The ABA does not endorse total repeal of the Act. The ABA is not advocating federal regulation of the insurance business. But the ABA does believe that no segment of the financial services industry should be allowed to collectively determine what products it will sell and what price it will charge for those products.

It might be asked why the American Bankers Association has chosen to take a position and testify on an issue which at first glance appears to solely affect the insurance industry. We have taken this step because banks, insurance companies, and other financial companies no longer compete in rigidly segmented markets. As eight members of the Senate Banking Committee recently stated in their supplemental views to the "Competitive Equality Banking Act of 1987", S.790, "It is clear to us that changes in technology and innovation, as well as changes in the economy and in the global, competitive marketplace, have outpaced the current regulatory framework that has served us for many years." A broad range of experts in private industry, the regulatory agencies, Congress, academia, and the press now recognize that the traditional distinctions between financial companies have been blurred at a rapidly accelerating pace and that it is neither desirable nor possible to reverse this trend. For example, in January the President of the Federal Reserve Bank of New York, E. Gerald Corrigan, published a major essay — "Financial Market Structure: A Longer View" — in which he argued that a return to rigidly segmented financial markets was not feasible and that a new and relevant regulatory structure was needed which would permit the establishment of financial service holding companies able to freely choose to engage in banking, securities, insurance, and other financial activities. Recently, the American Bankers Association endorsed the concept of a financial service holding company and we are presently considering what broad principles should guide the proper structuring of such a corporate entity.

Although we are hopeful that Congress will soon tackle the task of refashioning our financial laws to adjust to marketplace realities, it is important that your Committee realize that banks are already competing head-to-head against insurance companies. Any company may own a thrift institution insured by the FSLIC, and many insurance companies have taken advantage of that avenue to providing insured deposit services. And insurance companies own dozens of nonbank banks which, even if addressed by Congress, are likely to be grandfathered with only minimal perspective restrictions, as demonstrated by the provisions of S.790 relating to nonbank banks. Sears, which controls Allstate Insurance, issues the Discover credit card out of its nonbank bank. Prudential Insurance's TV advertisments promote the availability of FDIC-insured certificates of deposit issued by its nonbank bank. The Travelers Insurance Company has just developed a new package of financial services aimed at the American middle-class which are available if you authorize direct deposit of your paycheck into their nonbank bank. Capital Holding Company, a $7 billion life insurance underwriter, is marketing FDIC-insured interest bearing checking accounts through its nonbank bank. And one doesn't even need a nonbank bank to cross-sell traditional bank products with insurance and other financial services — for example, the Metropolitan Life Insurance Company is cross-marketing real estate brokerage, mortgage finance, and homeowners insurance through its Century 21 real estate network.

Even more fundamentally, basic insurance products now compete directly with traditional banking products. For example, many insurance policies are now in reality part insurance, part savings and investment; they compete directly with bank savings products. On the asset side, banks and insurance companies in many instances are making the same types of loans.

The banking industry is subject to a dual state and federal regulatory system which includes extensive supervision and regulation by three separate federal agencies — the FDIC, the Office of the Comptroller of the Currency, and the Federal Reserve Board. And not only is the banking industry subject to standard antitrust strictures, several banking statutes hold us to an antitrust standard even higher than that applicable to other industries. Senator Garn has introduced legislation, S.60, which would modify those laws so that we would only be subject to the same antitrust standards which other industries face. Regardless of the eventual disposition of that legislation, the American banking industry will continue to be subject to the full range of antitrust restrictions and does not believe it is equitable that it should have to compete against an insurance industry which is not subject to basic antitrust standards. Why should a bank holding company which controls a full service bank be subject to antitrust standards beyond the norm, when an insurance company which controls a thrift or nonbank bank is largely exempt from antitrust laws?

In an attempt to justify their own antitrust exemption and create confusion regarding the antitrust status of banks, the insurance industry has pointed to the banking industry's antitrust treatment as in some way analagous to its own. Nothing could be further from the truth. First, as we pointed out, the banking industry is subject to pervasive regulation by three Federal agencies, as opposed to the virtual absence of Federal regulation of the primary activity of insurance companies. Second, the antitrust standards of the Sherman and Clayton Act have been written directly into the Bank Merger Act and the Bank Holding Company Act, and then additional tests have been added — such as the Bank Holding Company Act's requirement that permissible nonbank activities not only have no negative effects but must produce net public benefits. And, while banks themselves are exempt from direct regulation by the Federal Trade Commission, a bank holding company's nonbank subsidiaries are subject to FTC rules. And banks are only exempt because, when the FTC issues a rule which is applicable to activities engaged in by banks, the Federal Reserve must issue the same type of regulation, as it did in the area of credit practices. Finally, in order to accomplish a bank merger or bank holding company acquisition, the banking organization must first satisfy the appropriate banking regulator that the proposal adheres to the antitrust laws, and then that decision is subject to Justice Department review.

To sum up, there is simply no similarity between the banking industry — with its multiple Federal regulators and its need to adhere to the full range of antitrust laws, enforceable by those regulators as well as the Justice Department — and the insurance industry, with its antitrust exemption and the absence of Federal regulation of its core business activity.

BANKING AND INSURANCE

SIMILARITIES

Aside from gross disparity in antitrust treatment, the banking and insurance industries are strikingly similar. Insurance and banking are simply different methods of managing financial risk which complement one another in the financial plans of individuals and businesses.

Banks are leveraged institutions that fund themselves by soliciting deposits that they invest by making loans and purchasing securities. Banks assume and manage a wide variety of risks (such as credit, concentration, liquidity, and interest rate risks) in order to be able to pay their depositors at the time and in the manner that they promised, and still have left over sufficient income from their investments to provide a fair return to their shareholders.

Insurance companies are leveraged institutions that fund themselves by soliciting premiums which they invest by making loans and purchasing securities. Insurance companies assume and manage a wide variety of risks (such a actuarial, concentration, liquidity, and interest rate risks) in order to be able to pay their policyholders, the insured, at the time and in the manner they promised and still have left over sufficient income from their investments to provide a fair return to their shareholders or other owners.

From a producer's point of view both banking an insurance involve four functions — origination, investment, processing and liability management. The only substantive difference between banking and insurance is in the degree of probability or predictability of the events that bring about a requirement to pay out on the liability side. And even here the differences are not that dramatic.

Origination means understanding the customer's financial problem, developing a solution, and issuing the appropriate instruments to solve it. Banks have developed an understanding of these problems and how they can be solved. What they need is the authority to implement a full range of solutions.

Investment concerns the management of the firm's assets. Banks have extensive experience in managing the assets in which insurance companies invest. Thus, banks could manage an insurance company portfolio without difficulty.

Processing means just what it says -- managing the flow of paper and electronic data necessary to complete a transaction. Banks operate the payment system for the world's largest economy and could easily perform the collection and disbursement activities that insurance companies engage in.

Liability management does differ between banks and insurance companies. Banks must manage their assets and liabilities in order to meet their depositors' demands. Such demands are predictable only to a limited extent. Insurance companies must manage their assets and liabilities in order to meet policyholders' claims. But many of these claims are substantially predictable, as evidenced by the reliability of mortality statistics used to set life insurance rates and coverage. Property and casualty events are, of course, less predictable, but here too, volumes of statistics on property and casualty risks make predictability more than a betting game.

Turning to specific product areas, life insurance exhibits strong similarities to bank offerings. For example, the traditional whole-life policy contains a tax-deferred savings account and a pre-approved line of credit that allows the policyholder to borrow against the cash value of the policy. Variable or universal life insurance allows the insured to invest his savings in a tax-deferred mutual fund, similar to that offered by banks in IRA or Keogh accounts. Thus, life insurance, with the exception of term policies, is a savings vehicle.

As for property/casualty insurance, it too has strong similarities to banking. On the asset side, insurers assume the same type of investment risk incurred by banks as managers of their own portfolios or as managers of trust assets beneficially owned by others, such as pension funds. On the liability side, banks must continuously appraise, in connection with their extension of credit, the value of property such as autos and homes.

In addition to these many similarities between the functioning of the banking and insurance industries, marketplace evolution is erasing the distinctions between many banking and insurance products. For example, there is no functional difference between a bank's standby letter of credit or an insurance company's financial guarantee, both of which are issued in conjunction with securities offerings and both of which compete for that business. The functional equivalency of many bank/insurance products was noted by the Federal Reserve Board in its March 20, 1986 approval of Citicorp's application to underwrite and reinsure home mortgage redemption insurance. The Board noted that its decision departed from precedents because "market developments have narrowed substantially the differences between credit life insurance and home mortgage redemption insurance". In reaching its decision the Board determined that there would be considerable net public benefits from Citicorp's entry, including the availability of insurance products with a greater variety of features.

STATES' RIGHTS

We are aware that the insurance industry is resisting any modification of the McCarran-Ferguson Act with the claim that any change in the law would violate states' rights. For example, the February 9, 1987 issue of Legal Times quoted an official of the American Council of Life Insurance as stating that the association would respond to the complex debate surrounding this issue with a plan to "reduce it to the simplest level...a question of state vs. federal regulation". As I previously noted, the ABA is not aware of any active Congressional proposal to impose federal regulation on the insurance industry; nor have we called for such regulation. We applaud S.1299's reaffermation of the states' authority to regulate insurance. Nonetheless, I must point out that in general the insurance industry's consistency as a defender of states' rights leaves much to be desired. We are particularly concerned with the insurance industry's on-going effort to enact federal legislation to deny state legislatures the authority to grant insurance powers to state chartered banks operating within state chartered bank holding companies. Fortunately, the full Senate rejected that grave afront to states' rights by adopting the "Breaux amendment" to S.790. Were such anti-federalist legislation to become law, it would pull the rug out from under the nine state legislatures which are considering the granting of expanded insurance powers to banks during their 1987 legislative sessions. Had that afront to states' rights been the law last year, the states of Florida and Ohio would have been largely blocked from their decision to give state banks the right to engage in reinsurance as one means of addressing their liability insurance crises. Ironically, the Ohio statute was strongly endorsed by that states' Independent Insurance Agents Association, whose Senior Executive stated "the immediate crisis facing Ohio citizens and businesses today is very real and immediate. Something must be done to restore a viable insurance marketplace in Ohio."

The legislative history of the Bank Holding Company Act demonstrates that Congress never intended to grant the Federal Reserve Board jurisdiction over state-chartered banks which are controlled by a holding company; that it preserved the separate states of laboratories for financial innovation, in keeping with our federal system of government. During Senate Banking Committee hearings on the Bank Holding Company Amendments of 1970, FDIC Chairman Frank Wille commented that an interpretation to the effect that the Bank Holding Company Act invested such preemptive powers in the Board could be questioned on Constitutional grounds. And, perhaps more relevant to your inquiry today, when asked about any dangers that might arise from a multienterprise state bank, he responded:

> If the activities of the multiactivity bank were to violate antitrust concepts, we do have an arsenal of antitrust legislation already on the books and that legislation presumably could reach any banking or business organization, regardless of how it is chartered. (emphasis added)

Similarly, Federal Reserve Chairman Arthur Burns testified at those same hearings regarding the effect of the subsequently enacted legislation:

> The Board would then be simply regulating the bank holding companies, not the banks themselves. The banks would continue to function under their present supervisory authorities...Therefore, the distribution of regulatory functions, as far as the banks are concerned, would remain entirely unchanged. (emphasis added)

Statements made in both Committee reports and floor statements by many members of both the Senate and House Banking Committees reinforce the point that Congress in no way intended to give the Federal Reserve authority to circumscribe the powers of state chartered banks controlled by holding companies when it enacted or amended the Bank Holding Company Act. Further, the plain language of the statute reinforces that reading. For example, the nonbank subsidiaries of a bank are specifically excluded fom the scope of the Board's authority to order cessation of activities. And Section 7 of the Act memorializes Congressional intent to prohibit the Board from assuming authority over state bank powers, stating:

> The enactment by the Congress of this chapter shall not be construed as preventing any State from exercising such powers and jurisdiction which it now has or may hereafter have with respect to banks, bank holding companies, and subsidiaries thereof.

It is unfortunate that the insurance industry, despite its professed support of the principle of states' rights, continues to attempt to pervert the intent of Bank Holding Company Act and utilize it as a means of blocking the separate states from authorizing insurance powers for thousands of state chartered banks.

A true states' rights position would permit the states to authorize, if they wish to, bank entry into all aspects of the insurance business. There is good reason to believe that permitting banks to underwrite property and casualty coverage would help to prevent future liability insurance crises. A 1986 survey conducted by American Banker found that about forty percent of the nation's major banks would underwrite property/casualty insurance for both individuals and businesses if permitted to do so. The need for additional capacity in the insurance underwriting field was amply documented more than two years ago by the property/casualty industry's own non-profit statistical organization. The Insurance Service Office's February 1985 study on "The Coming Capacity Shortage" predicted that the availability of property/casualty insurance would fall short of demand by $62 billion in the 1985-88 time frame. That study's evaluation and recommendations section strongly questions the continuation of the insurance industry's strident opposition to entry by other financial entities, stating:

> "New Players? Given a capacity shortage - and society's need for risk protection - one must ask: Is it realistic to assume that our society will continue to countenance barriers to entry into the insurance business by other financial institutions? Those in the business who want to prevent new entities - with their available capital - from invading their turf may discover that these players are desperately needed in the next few years. New circumstances may call for a re-evaluation of positions that were initially forged when excess capacity was the order of the day."

Mr. Chairman, the ABA is in full support of the amendment which you added to the Federal Trade Commission Act of 1987 which would permit the FTC to investigate and report on the causes of the liability insurance crisis; and we urge that the FTC, in carrying out that mandate, investigate the extent to which prohibitions against commercial bank participation in insurance underwriting and reinsurance were a contributing factor.

Clearly, when the insurance industry seeks federal preemption of state legislative decisions to permit state chartered banks to engage in certain insurance activities, its consistency in arguing states' rights to defend McCarran-Ferguson should be questioned.

CONSUMER BENEFITS FROM COMPETITION

For some time the banking industry has contended that the introduction of new competition into the insurance marketplace, combined with distribution efficiencies of the bank branching network, could result in annual consumer savings on insurance premiums $6-$12 billion. Numerous surveys, including some conducted by the insurance industry, have shown that consumers rate banks more highly than insurance companies or agents, and that a substantial proportion of consumers would choose to buy their insurance from banks if permitted to do so.

A February 1987 study released by the Consumer Federation of America provides substantial new evidence of the potential consumer benefits of bank insurance entry. This CFA study, "The Potential Costs and Benefits of Allowing Banks to Sell Insurance", found that excess annual costs to consumers in the present life insurance system alone totaled $5-10 billion. CFA's survey of existing policies available from insurance agents versus banks* indicated "significant potential policy-owner savings" if banks could more freely engage in life insurance sales. The CFA report found "the savings banks and brokers based in banks sent policies that were lower in cost. The econometric study of life insurance costs...indicates that competition from banks could lower costs industry-wide". (emphasis added)

CFA's survey of sales practices show that "banks are more responsive to consumer requests for information" than captive or independent agents. The report goes on: "To summarize the responses to the survey, every one of the comparisons shows that bank sellers of life insurance were more forthcoming with information than agents...the policies sent by bank-based sellers were much lower in cost. This was true of both savings banks and bank-based brokers." In discussing insurance company agents who resisted or refused to send requested cost information, the CFA report states, "comments from many of these agents reveal that the reason for their reluctance is a fear of competition". (emphasis added)

Other important findings of the CFA report are:

- "The literature review establishes a clear economic basis on which potential cost savings to consumers might be based".
- "Insurance subsidiaries of financial and nonfinancial companies have lower operating costs and lower policy-owner cost."

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* Savings banks have been permitted to sell and underwrite life insurance for decades in several northeastern states, and a number of midwestern states have long permitted banks to own insurance agencies.

- "The best available direct evidence suggest that competition between different institutions does operate to lower costs to consumers...there is no clear evidence that bank diversification results in greater concentration".

"The survey evidence does not indicate a great potential for tying or the existence of a great deal of tying in those areas where banks currently sell insurance." (emphasis added)

In its discussion of the policy implications of its findings, the CFA report states that careful regulatory policies to maximize consumer benefits and minimize undesirable practices or results should accompany bank entry into the insurance business. If bank entry was accompanied by rigorous disclosure of key consumer information such as premiums, surrender values and rates of return, the CFA found bank entry "a particularly positive element to inject into the industry". The banking industry would be very receptive to reasonable disclosure requirements as part of any legislation authorizing bank sale of insurance.

In conclusion, the CFA report states, "the dilemma facing consumers and policymakers is that the current regulation and structure of the insurance industry leaves a great deal to be desired. Bank entry could not only capture the unique benefits associated with direct bank sale of insurance, it might also drive the industry to perform better as a whole....the potential benefits are large enough for policy-makers to work very hard at striking the proper balance. There is no reason to prohibit states from carefully expanding bank sale of insurance or federal authorities to dismiss bank sale of insurance out of hand". (emphasis added)

I would like to direct your attention in particular to the CFA report's finding that the evidence suggests neither great potential for tying or existence of tying, since banking's efforts to engage in insurance activities are always attacked by the insurance industry with the allegation that we have coerced consumers to purchase insurance as part of the loan transaction, and would do with a vengeance if our insurance activities were broadened. That unsubstantiated allegation is wrong for several reasons:

First, one must have market dominance in order to compel coercive tie-ins. In the field of consumer credit, there are such an abundance of loan opportunities today that there is major concern that some individuals are taking on too much debt. With this easy credit availability, there is no opportunity to force consumers to accept unwanted financial products as a condition for loan approval, nor would it be in the economic interest of a lender to reject a sound borrower on such grounds. The same situation holds true in the business realm -- in fact, a 1983 study commissioned by the American Insurance Association, Expansion of Banks Into Insurance, found that "there is little opportunity to buy significant market share in the property and casualty industry. Conversly, deposit taking institutions generally do not dominate their markets to such an extent that substantial market power could be used to force their way into markets by compelling the purchase of an insurance product by their depositors".

Second, coercion can arise in any situation where financial products are cross-marketed, regardless of whether credit is involved or whether the credit-granting institution is a bank, thrift, finance company, or other entity. For example, it is our understanding that some insurance companies now are refusing to renew consumers' automobile liability policies unless they also obtain their homeowners' coverage with that company. And the *Wall Street Journal* reported on September 10, 1985 that some insurance agents were compelling parents to purchase life insurance coverage in order to obtain Federally Guaranteed Student Loans for their children; these same parents later learned that "they easily could have gotten the same loan at a bank without any strings". If the Congress determines that consumers need additional protections against misunderstandings or coercion that may arise where financial products are cross-marketed, let's have those rules apply to all financial providers.

Third, consumers already receive legal protections when dealing with banks that are not present in other situations. For example, the Bank Holding Company Act makes tie-ins subject to treble damages and injunctive relief; interestingly, litigation has rarely been brought under these provisions, nor have many abuses been reported among the 1400 state chartered banks presently selling insurance in sixteen states. State laws also provide protections; most states require banks to accept equivalent policies when credit life insurance must be obtained to qualify for a loan.

Finally, consumers themselves have no problem with current bank insurance activities; almost all of which involve credit-related insurance, the very product most susceptible to tie-ins As noted, the CFA report found no evidence of tying abuses. Similarly, a February 1986 report to the Consumer Advisory Council of the Federal Reserve Board, reviewing consumers' experiences with credit insurance obtained on non-mortgage closed-end debt, found that nearly all borrowers who purchased credit insurance thought it was a good product and would do so again; and more than 95 percent of those borrowers felt that their decision to buy insurance had no effect on the creditor's decision whether to grant the loan. In other words, consumers felt no implicit or explicit tie-ins regarding this credit-related insurance.

Consumers, in fact, would like their insurance purchase options to include banks. A December 1985 survey by Syracuse University's Maxwell School of Citizenship and Public Affairs found that New York residents believed that banks should be able to sell insurance, that they were satisfied with the insurance they already purchased from banks (such as savings bank life insurance), and that they were dissatisfied with the current general insurance sales system.

Clearly, there is no evidence on which to base the contention that permitting banks to sell insurance will result in coercive tie-ins. However, if some additional Federal safeguards are required to assure the legitimate cross-marketing of financial products, they should apply to all financial providers -- to insurance companies as well as to banks.

Some have charged that the insurance industry's antitrust exemption under the McCarran-Ferguson Act is part and parcel of an anti-competitive structure which also encompasses the anti-rebate laws against retail price competition, and other protectionist measures. At the same time, banks are prohibited from meeting consumers' desires to obtain insurance from banks -- even though insurance companies are actively marketing bank-like credit and deposit products. If banking was granted additional insurance authorities, the consumers of insurance would be greatly benefited. Unbelievably, the Congress is under great pressure from elements of the insurance industry to go in the other direction and impose additional new restrictions on bank insurance authorities.

NO JUSTIFICATION FOR CONTINUED ANTITRUST EXEMPTION

If exempting the insurance industry from the antitrust laws was a question of first impression, we doubt that Congress would seriously consider granting such a blanket exemption to an industry whose annual premium income is about nine percent of GNP. Industry-specific antitrust exemptions are contrary to the basic premise of the antitrust laws, as articulated by the Supreme Court -- "that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress". The 1979 report of the National Commission for the Review of Antitrust Laws and Procedures summed up the negative effects of this exemption by stating, "As presently interpreted the McCarran-Ferguson Act effectively may immunize from the antitrust laws a broad range of anti-competitive activities which in fact serve no federal or state objectives...there is simply no justification for retention of immunity in its present form."

Assuring the continued legitimacy of state regulation and taxation of the insurance industry was the primary motivation for enactment of the McCarran-Ferguson Act, with the antitrust exemption being a secondary consideration. The continuation of the antitrust exemption is not only unnecessary for the efficient operation of the insurance industry, it is in fact contrary to that goal. The exemption has never applied to all of the activities of insurance companies, but only to those which are (1) "the business of insurance", (2) "regulated by state law", and (3) not an "act of boycott, coercion or intimidation". Several Supreme Court decisions have progressively narrowed the concept of what activities constitute "the business of insurance". However, even as presently construed, the exemption continues to apply to such conduct as collective rate-making.

In addition, most courts have broadly construed the requirement that the insurance activity be regulated by state law so that it is satisfied when a state merely prescribes, permits, or authorizes certain conduct on the part of insurance companies in the most general terms, with the effectiveness of the state regulation hardly ever being at issue. "As a result", according to the 1979 report of the National Commission, "various types of collective insurance company behavior are, as a practical matter, wholly free from control by either state regulation or the federal antitrust laws".

If the insurance industry's antitrust exemption was terminated, the current antitrust laws would in all probability still permit the industry to engage in joint data collection activities, but they would restrict its ability to exchange information about future prices or to jointly set rates. Free and open competition would be encouraged. Other cooperative activities between insurance companies could also continue where they improve the industry's efficiency or allow groups of firms to offer services or products that no single firm could offer. Finally, the "state action doctrine" would continue to immunize anti-competitive activity where it is engaged in pursuant to a "clearly articulated and affirmatively expressed" state policy where that policy is "actively supervised by the state itself". Nevertheless, if the Congress should determine that exemptions from the antitrust laws are needed, specific, targeted exemptions could be narrowly crafted, as you have done in S.1299's "safe harbor" provisions.

In fact, one could argue that if the insurance industry is truly dedicated to preserving its state regulatory framework, it would embrace repeal of its antitrust exemption because the necessity of meeting the requirements of the state action doctrine would compel state regulation of insurance activities to become far more effective; and a truly effective state regulatory system is undoubtedly the insurance industry's best defense against any future call for federal regulation.

CONCLUSION

In conclusion, the ABA appreciates this opportunity to testify before your Committee regarding one means of introducing more vigorous competition into the financial services marketplace. We look forward to assisting you in furtherance of that goal. I would be happy to answer any of your questions.

Senator **Metzenbaum**. Thank you very much, Mr. Yingling. We appreciate your support and your comments.

Ms. Oaken, President of the National Federation of Business and Professional Women's Clubs.

Senator **Grassley**. Mr. Chairman, before I go, Senator Hatch has a statement that I would like to have printed in the record.

Senator **Metzenbaum**. Without objection, it will be included in the record.

[Prepared statement follows:]

PREPARED STATEMENT OF SENATOR ORRIN G. HATCH

Mr. Chairman, the earlier hearings on this topic are beginning to shape a discernible theme. The theme that emerges again and again from my standpoint is that the insurance industry is already intensely competitive.

These hearings have shown that there are somewhere in the neighborhood of 3,500 insurance companies in business. In fact the top five companies do not even account for 25 percent of the insurance business. It would be hard to imagine an industry with more robust competition.

In fact, these facts suggest that a repeal of the McCarran-Ferguson antitrust exemption may well be anti-competitive. Repeal of McCarran would not increase price competition in the industry, but it could decrease it. This would happen because some small companies could not compete without shared data. Insurance companies essentially market information. Without shared information, the small companies have no way to compete with the superior data-gathering skills of larger companies. *If these small insurers left the market, competition could decrease, not to mention the diversity of services to consumers.*

The second theme of these hearings is that the insurance availability and affordability crisis does not seem remotely related to the McCarran-Ferguson Act. Instead this so-called crisis, which according to many reports is subsiding rapidly, seems to be the product of the insurance business cycle.

High interest rates of few years ago triggered excessive competition for premiums that might be invested at a high rate of return. This excessive competition for premium dollars caused insurers to sell their product too cheaply. Accordingly prices had to be adjusted upward when the actual loss data began to appear. This problem can hardly be harmonized with repeal of McCarran-Ferguson. If the cause of the problem is too much competition, it would seem illogical to advocate a change designed to increase the level of competition.

In any event, I look forward to seeing how these themes continue to develop during today's hearing.

Senator **Metzenbaum**. Please proceed, Ms. Oaken.

Ms. **Oaken**. Thank you, Senator Metzenbaum. I am Mary Ray Oaken, President of the National Federation of Business and Professional Women's Clubs, with 140,000 members all across this country.

We fully support Senate bill 1299 to repeal the antitrust law exemption of insurance companies. BPW–USA believes that working women of this country need a more competitive insurance marketplace. The McCarran-Ferguson antitrust exemption drains the pocketbook of every working woman in this country.

Senator, I brought along a little symbol today. It is a red purse and it symbolizes that the insurance industry's exemption is dangerous to women in business and causes their pocketbooks to be more in deficit than they already are.

Without rate competition in insurance, women business operators and professionals are too often forced to pay scandalous rates for coverage. One example that I would like to use today is how it affects small business owners, and I would like to use the example of day care centers.

Insurance companies collectively raise their rates and small businesses are obligated to pay those prices or go without insurance. The sudden, dramatic rate hikes of the past 2 years suggest that insurance companies did just that.

Many studies have shown that day care centers are excellent risks because claims are rarely, if ever, filed against them. Nonetheless, in the summer of 1985 insurance companies either abruptly canceled their insurance or raised their premiums drastically.

An example of this devastating impact can be found in my home State of Kentucky. A study revealed that of 383 day care providers, 41 percent were being canceled or non-renewed, even though 75 percent had never had a claim during the last 5 years.

Senator, it is true that in most cases day care centers can find insurance, but they can find it only at unaffordable prices. To the day care center, whether they receive no price quotation or only unaffordable prices is irrelevant. In either case, the day care provider will not be able to buy insurance.

The second point that I would like to make is that our members are professionals, doctors, lawyers, accountants, psychologists, architects, and others. Like other small business people, they must buy liability insurance from a private insurance company, but have found that their rates have been skyrocketing since 1985.

If the antitrust exemption were repealed, insurers would not be able to raise their rates in concert, whether to small business people or to professionals. As a business woman, Senator, and a professional, we will take our chances in the competitive marketplace.

The third and final point that I would like to make is the antitrust exemption, in our opinion, hurts women. Today, insurance companies with McCarran-Ferguson protection gather together to determine how to categorize risks. For some types of insurance, they categorize risks on the basis of sex. They use sex as a risk factor, even though real risk factors can be attributed to miles driven, as in automobile insurance, or smoking for life and health insurance, or some other factor.

Using sex as a risk factor when, in fact, it is not causes some people to pay substantially more and others substantially less than the real risk of insuring them would justify.

BPW-USA believes that insurance companies should not be absolutely prohibited from making rates on the basis of sex if they can show that sex is, in fact, the real underlying risk factor.

On the other hand, if the true risk is mileage driven or smoking and not, in fact, gender, then we believe insurance companies should not be allowed to base those rates on sex rather than the true rate factor.

In conclusion, I would like to say that my organization believes that when women go to buy insurance, frankly, they might as well go to the cleaners because that is where they are being taken, and it is time that the insurance companies in this country scrape and claw in a competitive marketplace just exactly like the working women of this country are forced to scrape and claw if we are going to succeed.

So, Mr. Chairman, we support this legislation on behalf of our members and the 49 million working women in this country today who are insurance consumers.

Thank you.

[Prepared statement follows:]

Statement by Mary Ray Oaken

National President

The National Federation of Business and Professional Women's Clubs, Inc.

As the largest and oldest organization for working women, with over 140,000 members in every Congressional district, BPW/USA fully supports S. 1299 to repeal the antitrust law exemption of insurance companies, and thus permit scrutiny of its pricing practices. As small business owners and operators, professionals, consumers, and working women, BPW/USA members are at the forefront of promoting equitable reform of the insurance industry.

1. How the antitrust exemption hurt BPW members as small business owners and operators.

Of BPW/USA's 140,000 members, many are small business owners and operators. The antitrust exemption has had a particularly severe effect on small businesses, because unlike large businesses, they have neither the means nor the sophistication to self insure, and must consequently buy insurance from private companies. Thus, if insurance companies collectively raise their prices, small businesses are obligated to pay those prices or go without insurance.

The sudded, dramatic rate hikes of the past two years suggest that insurance companies did do just that. For example, many studies have shown that day care centers are excellent risks because claims are rarely, if ever, filed against them. Nonetheless, in the summer of 1985, insurance companies either abruptly cancelled their insurance or raised their premiums drastically.

An example of this devastating impact can be found in my home state of Kentucky. A study revealed that of the 383 day care providers, 41 percent were being cancelled or non-renewed even though 75 percent had never had a claim during the last five years. 1/ Similarly, an Indiana survey of 65 day care centers which had had only nine claims -- the highest for $1,500 -- found that 25 percent of those surveyed had been cancelled and that the others had their rates increased by an average of 125 percent. 2/

Finally, a survey by the National Association for the Education of Young Children of 269 day care providers throughout the country found that the claims against them were 3 percent of the premiums they had paid in 1985. Ninety percent had never had a claim filed against them, only three claims exceeded $500, and the highest claim paid involving any provider was for $15,000. Yet, more than one-third had their insurance cancelled, half had their rates doubled, 30 percent had them trupled and 10 percent had them increased by 500 percent. 3/

If insurance companies agree to refuse to write insurance at any price, they are in fact in violation of the antitrust laws even under the present McCarran-Ferguson antitrust exemption, which contains an exception to the McCarran exemption for "boycotts, coercion, and intimidation." As a result, day care centers that were unable to find insurance at any price have been able to file suit against insurers who suddenly withdrew from the day care market under the boycott exception to the McCarran exemption. 4/

However, in most cases, day care centers can find insurance -- but only at an unaffordable price. To the day care center, whether they receive no price quotation or only unaffordable prices is irrelevant -- in either case, the day care provider will not be able to buy insurance. Yet under the current state of the law, day care centers in the first case have a remedy, but in the second case do not. Repealing the antitrust exemption -- making price-fixing as well as boycotts by insurance companies illegal -- will give day care centers a remedy to the problem of unaffordable insurance.

The day care center example, of course, hits home for BPW/USA members in several ways. This inability to set prices will result in a competitive marketplace and lower prices to consumers. Like many working mothers, many of of our members rely on day care providers to enable them to work outside the home. Also, some of our members operate or work at day care centers, or provide day care out of their home. Thus, whether as providers or consumers of day care services, they are adversely affected by the insurance industry's antitrust exemption. This has the further effect of foreclosing employment opportunity and productivity to women who would otherwise be contributing participants in a competitive marketplace.

2. How the antitrust exemption hurts BPW members as professionals.

BPW/USA members are professionals -- doctors, lawyers, accountants, psychologists, architects and others. Like other small businesspeople, they must buy liability insurance from private insurance companies, but have found that their rates have been skyrocketing since 1985. If the antitrust exemption were repealed, insurers would not be able to raise their rates in concert -- whether to small businesspeople or professionals. This inability to set prices would result in a competitive marketplace and lower prices to consumers.

3. How the antiturst exemption hurts BPW members as consumers.

Millions of women drive, and millions of women own their own homes; therefore, they need both auto insurance and homeowners insurance. Comparison shoppping however, is virtually impossible due to the absence of accessible, understandable consumer information about insurance.

However, a document does exist that lists, for each territory in each state, the prices the dozen or so major insurance companies charge for two standard auto insurance policies and several homeowners policies. This document obviously could be a wonderful consumer tool, but the problem is that today the insurance industry's rate-making arm, the Insurance Services Office, circulates this document only to insurance companies and not to insurance consumers. Specifically, ISO is a national organization that collects and disseminates data from insurance companies, and then develops policy forms on a nationwide basis, although this agency may issue different rates for different states. If the insurance companies were bound by the antitrust laws, the industry would be obligated to make this document reasonably available to both sides of the market -- the buyers as well as the sellers.

In addition, to the rates charged by specific companies, this document also lists the rate that the ISO "advises" companies to charge. At certain times in certain states, many companies actually do charge the rate the ISO "advises" them to charge. Obviously, if the antitrust laws applied to insurance, this scheme would be entirely illegal.

Finally, sometimes insurance companies will not sell one type unless the consumer buys another type of insurance from them as well. For example, a company may refuse to sell me auto insurance unless I also buy homeowners insurance. In any other industry, this would be an illegal tying arrangement. The McCarran-Ferguson antitrust exemption makes such a practice legal in the insurance industry.

4. How the antitrust exemption hurts BPW members as women.

Today insurance companies, with McCarran-Ferguson protection, join together to determine how to categorize risks. For some types of insurance, they classify risks on the basis of sex -- i.e., they use sex as a risk factor, even though real risk factors can be attributed to miles driven (for auto insurance) or smoking (for life and health insurance) or some other factor. Using sex as a risk factor when in fact it is not causes some people to pay substantially more (and others, substantially less) than the real risk of insuring them would justify.

BPW/USA believes that insurance companies should not be absolutely prohibited from making rates on the basis of sex -- if they can show that sex is in fact, the real underlying risk factor. On the other hand, if the true risk factor is mileage driven or smoking, and not in fact gender, then we believe insurance companies should not be allowed to base those rates on sex rather than the true risk factor.

Unfortunately, insurance companies do not disclose the data that would allow legislators, the public and the press to determine what the true risk factors are. Because of the ISO, with McCarran-Ferguson Act protection, collects data according to sex, the insurance industry's current data base supports the classification of risks according to sex. A closer look at the data, on the other hand, might show that men have more losses than women, but that women and men who drive the same number of miles have the same loss experience. If this is true, one might expect that some companies -- for reasons of economic self-interest -- would decide to make rates based on mileage driven rather than sex.

The trouble is that, because of the McCarran-Ferguson antitrust exemption, the ISO has enormous power -- including the power to classify risks based on sex and the power to issue "advisory" rates -- and individual insurance companies are accustomed to classifying risks the way ISO classifies them and following the ISO "advisory" rate. If the McCarran-Ferguson antitrust exemption were eliminated, and thus the ISO's power reduced, more companies would be likely to make independent business decisions to classify risks in ways other than the ISO-recommended sex-based way.

In short, because of the antitrust exemption and the resulting enormous power of the ISO, the insurance industry is an industry that is entirely without "mavericks" that operate based on their own assessment of economic self interest rather than monolithic industry-wide practices.

In conclusion, Mr. Chairman, BPW/USA supports this legislation on behalf of our members who, as working women, are insurance consumers who need to get the best insurance coverage that they can obtain in a competitive marketplace. Such a marketplace does not exist today because of the McCarran-Ferguson exemption. We ask that this exemption be repealed and that a more competitive insurance marketplace be created. We believe that working women will benefit -- as consumers and as small business owners and operators.

NOTES

1/ Statement of Linda Locke, Advocacy Director, Community Coordinated Child Care, Louisville, Kentucky, before the Committee on the Judiciary, U.S. Senate, February 21, 1986, at 3.

2/ Statement of Deborah Phillips, Director, Child Care Information Service, NAEYC, before the Select Committee on Children, Youth, and Families, U.S. House of Representatives, July 18, 1985, at 3.

3/ Final Report of the Child Care Liability Insurance Survey of the National Association for the Education of Young Children (NAEYC), January 20, 1986.

4/ *See*, "Day care centers file insurance suit," The Denver Post, Jan. 17, 1986, at B-1; See also *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978); *State of West Virginia ex. rel. Brown v. St. Paul Fire & Marine Ins. Co., Civ* . No. 86-C-1400, Kanawha Cty. Circ. Ct. (W. Va., filed Apr. 14, 1986).

Senator **Metzenbaum**. Thank you.

Ms. Karen Knutson, or do you pronounce it Knutson?

Ms. **Knutson**. Knutson.

Senator **Metzenbaum**. Chairperson of the American Nurses' Association Council of Primary Health Care Nurse Practitioners. We are happy to have you with us.

Ms. **Knutson**. Thank you. Mr. Chairman, I am Karen Knutson, Nursing Director of 200 registered nurses, including 42 nurse practitioners or NPs, at Carle Clinic in Urbana, Illinois. As a nurse practitioner, I also deliver health care to nursing home patients.

As Chairperson of the NP Council of the American Nurses' Association, I appear today to present our views on the McCarran-Ferguson Act and to alert the committee to the severe crisis in nurse practitioner liability insurance.

There are about 30,000 NPs in the U.S. who provide a full range of health care services. Many NPs practice alone in inner cities, rural areas, often providing health care where none existed before. Over one-third of the NPs practice in communities of fewer than 25,000 population. Over one-half of their patients have annual incomes of under $10,000.

The country now faces a severe shortage of nurses, including NPs. This shortage is further exacerbated by the current professional liability insurance crisis. Mr. Chairman, the ANA has sponsored malpractice insurance for nurses at a rate of $58 per year for $1 million in coverage per occurrence and $3 million in the aggregate on an annual basis.

Chicago Insurance Company, CIC, now owned by Fireman's Fund, underwrites this insurance. Because the Fireman's Fund Company was not familiar with the nurse professional liability insurance, they retained an actuarial firm to analyze it. As a result, CIC, the last insurance company in the United States that accepted all types of NP applicants, initially informed ANA it would not renew the NP coverage.

Intense lobbying by ANA and several members of Congress forced CIC to reevaluate its decision and agree to renew coverage for one additional year for current NP policies, but at a premium of 25 times the present amount. This increase from $58 to $1,500 annually is too much for nurse practitioners, whose average annual salary is $26,000. Coverage also decreases and no new nurse practitioner applicants will now be accepted.

ANA has been told that an actuarial study indicated that of the 3,400 nurse practitioners insured in various programs, there were allegedly 21 claims in the past 4 years, resulting in $820,000 in claims and expenses. The average claim was $39,000, against a policy which guaranteed $1 million in coverage per incident.

Based on these figures, there is no justification for raising the premium to $1,500 annually for current insureds and not accepting new applicants. The only other insurance company which, to our knowledge, is accepting existing and new NP business on a national basis, unfortunately, excludes many types of nurse practitioners.

ANA has had discussions with over 50 other insurers in an effort to find a long-term national solution. Unfortunately, we have found that the companies will not consider the business without claims information.

Fireman's Fund has not been willing to provide it to ANA. Without such information, ANA is also not able to assess the possibility of establishing a risk retention group. The entire blame for this should not rest with Fireman's Fund. The entire insurance industry bears the responsibility for jeopardizing the practice of nurse practitioners.

Mr. Chairman, I and some of my nurse practitioner colleagues are covered under our employer's insurance. Consequently, we are not in the dire situation facing other nurse practitioners, this inability to afford the $1,500 annual premium, or even worse, not being able to qualify for coverage.

Nurse practitioners do not want to practice without adequate liability insurance. Yet, many NPs may not be practicing tomorrow because of their inability to maintain coverage.

On behalf of the largest health care group in the country, we ask the Committee to consider and pass Senate bill 1299, which would repeal the blanket exemption of the business of insurance from the Federal antitrust laws.

Thank you.

[Prepared statement follows:]

TESTIMONY
# of the
AMERICAN NURSES' ASSOCIATION

Presented by

KAREN KNUTSON, M.S.N., R.N.C.

Mr. Chairman, I am Karen Knutson, the Nursing Director and a practicing geriatric nurse practitioner (NP) at the Carle Clinic Association in Urbana, Illinois. I have management responsibility for 200 registered nurses, including 42 NPs, and I personally deliver professional health care services to patients in nursing homes. I am also the chairperson of the Council of Primary Health Care Nurse Practitioners of the American Nurses Association (ANA). I appear today on behalf of the ANA and its 188,000 members to present our views on the McCarran-Ferguson Act, and to alert the committee to the current severe crisis in nurse practitioner liability insurance.

BACKGROUND

The first educational program for nurse practitioners was developed in 1966 at the University of Colorado Medical Center. The early NP programs began as a direct result of the fact that not enough physicians were available in many geographic areas in the country. After graduation, many NPs practice alone in inner-city and rural areas, often providing access to health care services where none existed before. Many also provide care for patients who have been overlooked or slighted by a cost-oriented health care industry.

A nurse practitioner is a registered nurse who has acquired the additional education necessary to provide a full range of health care services. Nurse practitioners, like all nurses, emphasize health promotion and disease prevention. In their roles as primary health care providers, their functions include: health assessment, physical examination, development of a plan of care, instruction and counseling, use of laboratory data, diagnosis of routine illnesses, prescription of medications or other therapies as allowed by state laws, coordination of services, and referral when necessary. NPs do not practice medicine.

Congress has repeatedly passed legislation that acknowledges the need for nurse practitioners. Since 1975, Congress has appropriated funds to support development of programs for the education of nurse practitioners to work in settings such as long-term care and ambulatory care facilities. Federal funding has also been appropriated since 1975 for nurse practitioner traineeships which enable nurses to pursue a graduate degree as a NP when they would otherwise be unable to afford to do so. From 1975 through 1987, $135 million has been invested by the Federal Government in NP education.

Third-party payers are also becoming increasingly aware of the cost-effectiveness of NP services as indicated by their willingness to cover the provision of services by NPs that are typically provided by physicians. NP services are covered by: Medicare recognized health maintenance organizations, Medicare and Medicaid Rural Health Clinics, some state Medicaid programs, the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS), seven of the twenty-one fee-for-service plans within the Federal Employees Health Benefit Program (FEHBP), and private insurance companies in some states. Twenty-six states have adopted legislation enabling third party reimbursement for the services of specified categories of nurses. Of these, 14 specifically affect NPs. A 1986 Congressional Office of Technology Assessment case study Nurse Practitioners, Physician Assistants, and Certified Nurse Midwives: A Policy Analysis concluded that "Federal third-party payers could be more in step with new and evolving payment practices by liberalizing coverage and payment restrictions" for the services of NPs. The study's policy conclusions note that NPs clearly play legitimate roles in the health care system and have made important contributions to meeting the Nation's health care needs by:

- improving the accessibility of health care services;
- improving the quality of health care services;
- having the potential to reduce health care costs; and
- increasing the productivity of medical practices and institutions.

As a result of the Congressional enactment of the Medicare prospective payment system, health care is demanding more experienced registered nurses in specialty areas, and that means nurse practitioners. There are approximately 30,000 NPs in the country. In 1986, the Department of Health and Human Services indicated that over one-third of the NPs practice in communities of fewer than

25,000 population. Regardless of the type of practice or geographic setting, over one-half of their patients have annual incomes of under $10,000.

It is indeed cause for concern, therefore, that the United States is experiencing a well-documented severe nursing shortage, including a shortage of NPs. This NP shortage will be further exacerbated by the fact that there is currently a nurse practitioner professional liability insurance crisis.

LIABILITY CRISIS

Mr. Chairman, we regret to say that there is no insurance company in the United States that currently is accepting professional liability coverage for all types of NPs as new business. The last insurance company in the county that was accepting all types of new nurse practitioner applicants has recently announced that, effective immediately, it will refuse to write any new business in this area, and will raise rates dramatically for existing enrollees for one additional year of coverage.

The ANA has sponsored malpractice insurance for nurses at a rate of $58 per year for $1,000,000 of coverage per occurrence, and $3,000,000 in the aggregate on an annual basis. Maginnis and Associates is the administrator of professional liability insurance programs for ANA, most of its constituent state nurses associations, and most nursing specialty organizations. The Maginnis and Associates' program is underwritten by Chicago Insurance Company (CIC) a subsidiary of Interstate Insurance Group, which is now owned by the Fireman's Fund. CIC has underwritten nursing professional liability insurance since the early 1970's. Approximately 140,000 nurses are provided coverage by CIC. To the best of ANA's knowledge, the Fireman's Fund had never been involved or written malpractice insurance for the health care profession, until it purchased Interstate.

Because the Fireman's Fund management was not familiar with nurse professional liability insurance, they retained an actuarial firm to analyze this block of business. They came to a number of conclusions, including the fact that rates were too low for this type of exposure. They broke out the claims according to certain specialty groups and created "classes" of nurses. Based on the analysis, CIC decided that each class should pay a different rate. Initially, CIC had informed ANA that they did not want to provide any coverage to nurse practitioners, and therefore would not renew the coverage provided to NPs. As a result of this action, NPs would have had no insurance coverage available to them at any price.

After intense lobbying by ANA, with assistance from several Members of Congress, CIC re-evaluated the situation and decided to continue coverage for one year on a renewal basis for those NP policies currently being written; however, no new NP applicants seeking coverage will be accepted. Current insured will be allowed to renew for one more year, but at a premium 25 times the present amount, an increase from $58 to $1,500 annually. This premium is often unaffordable to NPs, whose average annual salary is $26,000. There will also be a decrease in coverage from $1,000,000/$3,000,000 to $1,000,000/$1,000,000.

According to a recent statement issued by the Chicago Insurance Company, the company is getting out of the business of covering NPs because NPs are practicing in an expanded registered nurse role. This expanded role, they say, will probably mean an expanded risk. However, their recent statement stated that the decision is not based on "the analysis of loss experience it had sustained for this and other categories of nurses. Previously, all nurses insured by CIC had been grouped in a single classification and paid the same rate. In fact, since Nurse Practitioners had not previously been identified as a separate class of nurses by CIC, it could not precisely identify the number of Nurse Practitioners it insures in its Nurses Program." It is difficult to understand how, with the lack of claims data on nurse practitioners, this company can justify the massive increase in premiums.

ANA disagrees that NPs are practicing at a significantly higher level of risk than other areas of practice currently covered by insurers. Two of the primary expanded functions of NPs that differ from those of other nurses are the prescribing of routine medications and the diagnosing of routine illnesses, such as colds or flu. These are functions that NPs have state sanction to perform. There is no evidence that these basic functions warrant placing NPs in the position of not being able to obtain affordable coverage, let alone no coverage at all.

ANA has been verbally informed that an actuarial study indicated that 3,400 NPs were insured in various Maginnis Programs. Allegedly, there were 21 claims during the past four years, resulting in $820,000 in claims and expenses. The average claim was approximately $39,000 against a policy which guaranteed $1,000,000 in coverage per incident. Based on these figures, there is no justification for raising the premium to $1,500 annually for current insureds, and not accepting new applicants seeking coverage whatsoever.

We are extremely concerned with the potential consequences of this decision. Millions of American consumers, who have relied on nurse practitioners for high quality and affordable care, may no longer have access to their services. NPs must have adequate liability insurance protection at premiums they can afford in order to practice.

The only other insurance company of which ANA is aware that will accept both existing and new NP business on a national basis unfortunately excludes many types of NPs. The Insurance Company of the State of Pennsylvania, a subsidiary of the American International Group (AIG), is the underwriter for a liability insurance program, administered by Cotterell, Mitchell, and Fifer, Inc. that will provide aggregate coverage of $1,000,000/$3,000,000 for certain NPs for a $81 annual premium. However, this program excludes all NPs who are self-employed or are involved in obstetrics/gynecology care and neonatal care. Most NPs in psychiatric and mental health counseling and most areas of family planning are also excluded. Mr. Chairman, this is a case where the exceptions swallow the rule. Of the approximately 1,200 graduates from NP educational programs in 1986, we estimate that no more than 20% could secure insurance under the Cotterell program. The remaining 80% of the new NP graduates would still be unable to secure any insurance coverage.

Certain states may have insurance regulations or laws that will make insurance available within that state. Some states, such as Indiana and Texas, have joint underwriting programs. Other states may have similar rules that can be utilized by NPs, but the premiums that would be charged under these arrangements are often unaffordable to NPs. ANA has had discussions with over 50 other insurers in an effort to find a long-term national solution to the problem. Unfortunately, we have found the companies will not consider the business without accurate claims information. Fireman's Fund has not provided ANA with this information. We continue to search for an insurer to write new policies for all types of NPs, but are skeptical that any company will take on the business without intervention from state insurance commissions.

Since nurse practitioners provide needed health care services, any action that restricts this practice is of national concern. As a consequence of a similar dilemma faced by nurse midwives in 1985-86, Congress enacted the Risk Retention Act. This legislation was intended to facilitate the formation of risk retention groups, thereby assisting those faced with limited options regarding insurance coverage. While not intended as a complete solution to the liability crisis, Congress did view risk retention as a viable option for adversely effected groups.

While no final decision has been made, the ANA is exploring the risk retention option. In order to accurately assess this option, however, the association needs accurate claims data. Without such data, it would be impossible to make critical decisions regarding the viability and cost of the risk retention approach. As noted earlier, Fireman's Fund has refused to directly provide the ANA with written information. Without such information, the ANA will be unable to make an assessment of our willingness to utilize the risk retention option. It would be an abrogation of the intent of Congress if groups such as ANA could not avail ourselves of this option because of an unwillingness by the insurance industry to cooperate. We do not mean to imply that the entire blame for this development should rest with Fireman's Fund. At least they have been willing to provide some coverage to NPs. It is the insurance industry as a whole which must bear the responsibility for jeopardizing the practices of NPs.

Mr. Chairman, myself and some of my NP colleagues are covered under our employers' liability insurance policies. Consequently, we are not in the dire situation facing other NPs. I have heard from several NPs though that they will be forced to drop their personal liability insurance policy because they cannot afford the $1,500 annual premium. Still other NPs, who have not had their own liability insurance because they have been covered under their employer's policy, are now finding that their employers are decreasing their coverage limits or refusing to cover them when they are performing NP functions. This makes the NPs nervous about their professional liability exposure. As a new applicant seeking NP coverage, they will be lumped in with recent NP graduates who are not insured, and will be turned down by the Chicago Insurance Company and Cotterell, Mitchell, and Fifer, Inc. if they fall into one of the numerous exceptions.

Nurse practitioners do not want to practice without adequate liability insurance coverage. Yet many NPs may not be practicing tomorrow because of their inability to maintain liability insurance coverage.

MCCARRAN-FERGUSON EXEMPTION

As our testimony indicates, nurse practitioners, and the patients they serve, face a real crisis with respect to insurance. It is unfortunate that NPs face the choice between two equally unpleasant alternatives: a massive 2500% increase in premiums, or going without insurance coverage altogether. It is equally unfortunate that a partial solution to this problem is not available because of the antitrust exemption afforded to the insurance industry by the McCarran-Ferguson Act.

We do not assert that the repeal of this immunity will totally solve the insurance dilemma faced by nurse practitioners. It is regrettable that, because of the paucity of regulation by the federal government of the industry, there is no single federal remedy to this problem. It is a source of tremendous irritation and frustration to our membership when we tell them that there is no single federal response to their career-threatening situation. But, one move the federal government could take to address the problem would be the repeal of McCarran-Ferguson.

The refusal of the insurance industry to offer coverage at reasonable rates, or in most cases at no rate whatsoever, to a valuable group such as nurse practitioners, should be an action which is subject to antitrust scrutiny. In any other industry, this would be the case. If physicians were making a concerted effort to put NPs out of business, the Federal Trade Commission and the Department of Justice, along with the individuals actually affected, could take action. In fact, we believe that a major reason such anti-competitive actions do not occur is the presence of antitrust authority at the federal level. However, a similar action by the insurance industry, with the same effect, is off bounds to such investigations. In our view, there is no justification for this policy.

Repeal of the McCarran-Ferguson antitrust exemption would allow federal antitrust authorities to look behind the actions of the industry to determine whether a conspiracy against nurse practitioners exists, or whether this is simply an elaborate form of price-fixing. We would like to believe that such is not the case. However, since the industry will not show us the data which justifies their elimination of coverage for NPs, or increase in rates to an astronomical percentage, we must believe that antitrust scrutiny is warranted. We cannot accept a situation where major changes in coverage are unilaterally imposed without any justification. Such actions make us wonder why this change in coverage has occurred, and by whom such a decision was made. The McCarran-Ferguson exemption prohibits us from answering these questions, thereby necessitating its repeal.

We are not contending that repeal of this immunity will entirely solve the problems of nurse practitioners. This is also not the only action which could be taken by the federal government, as legislation to require adequate data collection is also necessary. But we also believe that, if antitrust remedies were available, this incident would not have occurred, or would change as soon as scrutiny began. If nothing else, the FTC and the Justice Department could find out exactly why rates have risen so dramatically. If this action was justified because of hard data, we would have to accept it. But to not know why such a radical decision was made, and to be cut off from using the antitrust laws to discern the reasons behind the decision, is the worst possible situation any group could face. Our members have an overwhelming feeling of helplessness because arbitrary and capricious decisions have been made, and there is nothing they can do about it. Equity demands that such a situation not be permitted to occur.

Therefore, we ask the committee to consider and pass S. 80, which would repeal the antitrust immunity enjoyed by the insurance industry. The current struggle faced by nurse practitioners presents a textbook reason for such repeal. It would allow the government or the affected parties to determine the rationale for the radical change in coverage policy. It would force the industry to justify its actions, as every other industry must do. Most importantly, it would provide a remedy to actions which we believe threaten the public health of this country. No industry should be permitted to take actions which adversely affect the health of our citizens, and not have to be accountable for those actions. If the industry can make its case before federal authorities, then it has nothing to fear. If not, the law should be enforced. On behalf of the largest health care group in the country, we ask that you repeal the antitrust immunity currently afforded the insurance industry.

Senator **Metzenbaum**. Thank you very much.

Mr. Randall, you are our last witness and you represent the Automotive Service Association, Inc. We are very happy to have you with us, sir.

Mr. **Randall**. Thank you, sir. We thank you for including our full statement in the record.

Senator **Metzenbaum**. It will be included.

Mr. **Randall**. Mr. Chairman and members of the committee, we appreciate the opportunity to testify about S. 80 and S. 1299. Accompanying me today is Mr. Tom Justice and Mr. John Padula. Both are auto collision shop owners who are expert technicians, and both are from Ohio. Following my summary, we will be happy to try to answer any questions that you have.

ASA is the oldest and largest national automotive service trade association representing over 10,000 members nationwide. Approximately half are auto body collision repair shops.

The insurance industry is essentially unregulated. Not even the largest States effectively regulate this industry. Most States have deregulated commercial insurance. Thus, there is a hiatus, no Federal oversight, and no independent collective data—ineffective or non-existent State regulation.

I heard the earlier insurance witnesses commenting about the intensive competition. There has been an era of irresponsible and irrational below-cost selling by the insurers, and that, in fact, is the reason we have the current insurance crisis.

But without any data and with no Federal oversight, we do not know if that below-cost selling was predatory, aimed at getting rid of troublesome small insurers who may be a competitive thorn in their side.

If there is any reason alone for ridding this industry of the antitrust exemption it has, it is to subject them to the disciplines of competition and the rigors of antitrust oversight so that we can look at their activities and find out if, in fact, they are engaging in below-cost sales and predatory behavior to run small companies out of business. We do not know that answer; we do not have the data.

The casualty insurance industry is $300 billion a year. It not only enjoys an unprecedented antitrust exemption; it abuses that unique status and inflicts a multi-billion injury upon the 32 million vehicle owners whose vehicles are damaged annually.

The insurance industry has become the regulator of the $30 billion-plus collision repair industry. No other segment of industry in the United States is subject to such perverse private regulation.

The insurers have assumed the role of wage and hour regulators. Yet, they themselves are essentially unregulated. They maintain a huge army of regulators at an enormous cost. That is why auto insurers return only 65 cents out of about every dollar that they collect in premiums. The rest is paid out in an enormous cost for administering the claims settlement system that breeds the dissatisfaction that millions of American motorists experience annually.

During the Nixon administration, our Nation tried to regulate prices and wages. It failed miserably, but in the process it caused great hardship and economic dislocation throughout our economy. Similar hardships and economic dislocations are now occurring in the auto collision industry.

Shops are going out of business, technicians are leaving this industry to go into higher-paying jobs installing aluminum siding and mechanical repairs to buses and other things.

Of equal importance, though, are the millions of American motorists who are being returned vehicles that are not fully restored to their pre-crash values, thus inflicting an economic loss upon the 32 million vehicle owners whose cars and trucks are repaired annually.

We estimate, and say that this is a very conservative estimate, that of those 32 million cars that are repaired under this claims settlement system dominated and controlled by the insurers, the depreciated condition of those vehicles is accelerated by at least $100 per vehicle. That is $3.2 billion in economic loss to the vehicle owners of America annually because of this domination, control, and establishment of a system that insists upon mediocrity in repairs.

They want freedom to compete themselves, but they want to control a major segment of our industry today and we feel that it is inappropriate. The insurers' criteria or level for repair or degree of quality varies. Generally, insurers are satisfied with a mediocre or commercial standard repair.

I will not go into the details of how the system works. It is in my complete statement, but we would end by saying that we compliment this committee for undertaking the study of this particular legislation. We feel that the competing slogans that the industry engages in are not the way that competition ought to work.

They ought to be subject to real competition. They ought to be subject to competition in their claims settlements. They ought to promote what they will give and they ought to write policies that are clear, and compete in the way the policies are constructed.

Your one Section 3 in your bill, S. 1299, contains a provision which would permit them to engage, we believe, in uniform selection of policies and terms and conditions, and that would be a travesty, we believe, upon the American insureds. But we, in general, support your program as you have proposed it. Thank you.

[Prepared statement follows:]

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STATEMENT ON BEHALF OF THE AUTOMOTIVE SERVICE ASSOCIATION, INC.

BEFORE THE U.S. SENATE JUDICIARY COMMITTEE

BY

DONALD A. RANDALL, WASHINGTON REPRESENTATIVE

June 2, 1987

The insurance industry is essentially unregulated. Not even the largest states effectively regulate this industry.[1] Most states have deregulated commercial insurance. Thus, there is a hiatus -- NO FEDERAL OVERSIGHT -- NO COLLECTIVE DATA -- ineffective or non-existent state regulation. The 300 billion dollar casualty insurance industry not only enjoys an unprecedented antitrust exemption, it abuses that unique status and inflicts a multibillion dollar injury upon the 32 million vehicle owners whose vehicles are damaged annually.[2]

We estimate that each of those 32 million vehicles repaired under a claims settlement system, **dominated and controlled** by the insurers, is returned to owners in a depreciated condition -- averaging at least $100 per vehicle. That's $3.2 billion annually in economic losses to vehicle owners.

1/ NBC-TV News, "Insurance, Protection for Sale," Chris Wallace, 1983.

2/ Insurance Services Office, Inc. reports 32 million auto property damage claims 1985.

In 1985, the country-wide average paid-claim-cost for property (vehicle) damage was $1,217.[3]

The total economic costs of auto accidents in 1985 was $79 billion.

BRIEF HISTORICAL PERSPECTIVE

In the 1950s, the average hourly labor rate for body shops was higher than the mechanical labor rate. Skilled metal refinishers were paid more than mechanical technicians. Today, this is reversed.

Beginning in the 1960s, insurers began efforts to hold down auto casualty claims. Their primary efforts were aimed at physical injury losses and little attention was paid to property losses. In fact, most insurers were more concerned with earnings on investments than in mitigating or reducing losses.

By the late 1960s, due to a Congressional investigation by this subcommittee of the auto repair industry, the insurers became aware that auto property losses were becoming almost as large as physical injury claims. The insurers became increasingly interested in loss prevention programs. Three estimates of vehicle damage became the routine requirement.

Many body shops exchanged estimate pads and thus ushered in the courtesy estimate era. Shop owners felt they were doing vehicle owners a favor by saving them the effort of visiting two additional shops for estimates. However, it became evident that

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3/ Insurance Services Office, Inc., N.J. (Includes adjustment cost).

the other two courtesy estimates were invariably higher and thus the primary shops' "estimate" was the winning low price.

In an effort to overcome the "courtesy estimate scam," insurers increasingly employed in-house employees who were damage appraisers.

The drive-in claim offices of insurers began to be more prevalent and the era of in-house insurer claims settlements became entrenched.

By the mid-1970s, the practice by insurers of appraising the vehicle's damage and offering owners predetermined and usually fixed amounts for repairs became the prevailing practice of many insurers. A phenomenon began developing. The insurers, who technically have no legal ownership in their insureds' vehicles, began acting more and more like they -- the insurers -- were the purchasers of repairs to the vehicles.

By the mid-1980s, not only were insurers acting like the buyers of auto body repairs, but also a series of court decisions had actually declared the insurance companies as the purchasers of the repairs to the vehicle owners' vehicles.

CURRENT SITUATION

Previously, the insurer had simply been a third party negotiator on behalf of the vehicle owner who was the legal party to contract for repair of the vehicle. Now, insurers, acting as the buyers of the repairs, endeavor to buy the repairs at the lowest possible price. What's wrong with that? If you or I go out to purchase a television set, we normally look for and buy at the lowest price. The principal difference is that a specific model of T.V. will be of uniform quality regardless of where it is purchased. Auto repairs are not of uniform quality. They vary, depending upon the shops' equipment and technicians' expertise.

Yet today, in 90% of collision repairs, the insurer, acting as the purchaser, goes out into the marketplace and determines the uniform hourly labor rates for charges by body shops to their customers -- the vehicle owners. These uniform rates are set regardless of the quality of repairs or the cost of the vehicle. INSURERS ALSO ARE INCREASINGLY REQUIRING SHOPS TO INSTALL NON-ORIGINAL-EQUIPMENT (NON-OEM) SHEET METAL, OR SALVAGE PARTS, OR TO USE SECTIONING PROCEDURES (the use of salvage or parts of new components welded onto the insured's car). These off-shore non-OEM parts frequently do not fit and have caused rust and corrosion problems. They are frequently not of like grade and quality (Exhibit A).

These photographs are of vehicles that have been repaired at the insistence of the insurer using sheet metal parts that were not of like grade and quality (Exhibits 1-7, to be submitted).

These photographs are of a vehicle that was "butchered" in a repair shop designated by the insurer. This vehicle was so poorly repaired that the owner could not even drive the car safely. The owner had to fight his insurance company to re-repair the car. The original mis-repair cost $2,500; the re-repair cost an additional $3,567.51. (Exhibits 8-11).

These photos clearly depict the substandard condition of these non-OEM (so-called off-shore Parts) which insurers insist that body shops use (Exhibits 12-15).

These photos show sectioning repairs that subsequently failed when the car was again involved in another low-speed accident (Exhibits 16-17).

Additionally, the pressure by the insurers has inordinately promoted the rapid growth in importation of foreign-made sheet metal parts from Taiwan, Korea, Italy and Mexico.

AUTOMOTIVE BODY STAMPINGS
IMPORTS FROM TAIWAN

YEAR	CUSTOMS VALUE	ANNUAL GROWTH	
1978	$38,000	-	197% COMPOUNDED ANNUAL GROWTH 1978-1984
1979	$223,000	487.0%	
1980	$227,000	24.0%	
1981	$2,413,000	344.0%	
1982	$9,241,000	283.0%	
1983	$16,052,000	74.0%	
1984	$26,033,000	62.0%	
1985	$27,310,000	5.0%	

SOURCE: U.S. DEPARTMENT OF COMMERCE

Table No. 1

Table No. 1 shows the artificial rise in dollar volume of imports of these non-OEM parts. Except for the requirements by insurers, the quality of these parts would not have resulted in this demand.

The insurers' criteria for level of repair or degree of quality varies. Generally, insurers are satisfied with mediocre or "commercially acceptable" or "commercial standard" repairs, so long as they are at or below the insurers' predetermined and specified "prevailing rate."

In fact, most insurers insist on the repairing-shops' agreeing to charge the shops' customers the insurer-dictated "prevailing rate" regardless of the make or model vehicle or its original cost. Therefore, a Mercedes 300 and a Ford Escort both must be repaired at the standard prevailing hourly rate. A vehicle owner who insists that the vehicle be restored to its pre-crash condition by a high quality restoration may well find that under the variable and indefinite terms of his policy, he will be compensated only for a mediocre or customary commercial standard. If he wants the vehicle fully restored to its precrash value and condition, he no longer has a fixed deductible. His insurer requires him to pay the higher cost for the quality restoration. We know of no insurance policy that discloses this condition. If the insured accepts the insurers' mediocre or commercial standard repair, the vehicle is returned with a greater depreciation or loss in value to the owner. We estimate the loss to be at least $100 per vehicle.

To the insurer who pays the lowest possible price, this is just good business practice and "helps hold down premium costs." But it costs vehicle owners in loss of value to their vehicle. Therein is the secret underlying incentive for insurers to keep and administer claims under insurance policies that are vague, confusing, indefinite and written so that the insurer may reap more benefits. As a result, the insureds suffer real economic losses, and they are generally not aware they have incurred the loss. The total loss we estimate at $3.2 billion annually or about $100 for each of the 32 million vehicles. In some instances the loss amounts to thousands of dollars.

What would happen if the bankers, who lend money to vehicle purchasers and have a legal fiduciary interest in the vehicle, were to go to the repair shops and insist that the shops charge the highest prices necessary to fully restore these vehicles to their precrash value? These financial institutions have a far greater financial and legal interest than do the insurers. The banks do not want to lose the security value in these vehicles; yet to date, the bankers have not entered into the third party negotiation with repair shops to require the highest quality repairs. Who knows, maybe they will and then the courts will have to decide whether the buyer of the repairs is the vehicle owner, the insurer or possibly the bank.

The insurers know that most vehicle owners are not aware of vehicle design changes that vitally affect the safety and operating condition of today's new technology cars.

The average car owner is not capable of judging the quality of collision repairs. They know only if the paint job appears satisfactory. Most don't even know how to look down the side of a car under good light to detect ripples and unsatisfactory paint jobs, let alone poor steering, suspension or drive train repairs. Few can identify whether emission controls are repaired and operating correctly. Critical safety systems confound the average motorists.

Body Shop Business magazine in 1983 carried an excellent article entitled, "Consumers Are Not Aware." A relevant part is quoted hereafter:

> Unaware of Unibodies
>
> Let us take a look at the average motoring consumer and list what he/she knows about their vehicle, what happens when the car is collision damaged, what they know of the claim procedure and their rights in dealing with restoring their vehicle to pre-accident condition.
>
> 1. The average motoring consumer is not aware that the unitized car he/she is driving is different.
>
> 2. They are not aware that the unitized car is purposely designed with collapsible zones to protect the passenger area in the event of a collision.
>
> 3. They are not aware of the new alloys and plastics which are used in the manufacture of the unitized cars in order to save weight and improve gas economy or that new materials require special repair techniques and shop equipment.
>
> 4. They are not aware that because of the unitized car's design, an impact in one area of the car causes damage to be transmitted to other areas of the car; and this transmitted damage is not easily detectable by the naked eye. The unitized car requires careful measurement in collision damage repair.

5. They are not aware the proper procedures for handling their insurance claims, and their rights in dealing with the insurance companies.

6. They are not aware the proper procedures to use in order to authorize and receive satisfactory collision repairs, so that they are guaranteed that their vehicle will be restored to pre-accident or better condition.

In short, the average motoring consumer knows very little about his or her car and/or how to get it fixed properly.

An uninformed consumer is easily itimidated.

The average motorist is involved in an accident once every four years. And, when confronted with unfamiliar insurance claim procedures as a result of an accident, the motorist is unconsciously intimidated by the fact that they must now deal with an insurance company which is worth millions and millions of dollars --- a business giant. Because of this conscious state of mind, insurance companies have an advantage in dealing with the claim procedure. Therefore, in the repair cost negotiation process, insurance companies have the advantage.

How can the negotiation process be changed so that the collision repair shop has a more favorable position? By educating the motoring consumer, that's how!

ASA urges the Congress to carefully study S. 80 introduced by Senators Metzenbaum and others. It represents a good beginning for harnessing this gigantic essential industry.

It is long past time to compel the insurers to become disciplined by the forces of a truly competitive marketplace.

Competition in the claims settlement practices and procedures will result in benefits to millions of insureds.

Removal of the unbridled exercise of market domination and price controls by the unregulated insurance industry will unleash the disciplines of competition on the automotive collision repair industry. Competition in quality, service and prices for repairing damaged vehicles will replace the present system of mediocre, commercial standard, insurer price-fixed repairs.

Maybe the auto insurers will compete in offering to pay higher hourly rates to repair Mercedes or BMW's or other luxury-priced cars. Conversely, maybe they will compete by offering cheaper rates on Pintos, Hondas, Novas and other inexpensive cars, because they offer lower hourly labor rates on those repairs. Maybe their policies will actually disclose what they will pay in claims. They might even be readable and understandable.

Possibly, instead of just competing in slogans like "good hands, on your side, good neighbor," they will compete by selling the quality of service they give in their settlement of auto claims.

The nation will benefit from a closer Federal oversight of this vital industry. Gathering of information and data at the Federal level and its avilability will assist the poorer states and smaller insurers.

Federal antitrust oversight is entirely compatible with and, in fact, essential to effective state regulation of the insurance industry.

Congress should spell-out what minimum state regulation is required, particularly if the insurers are to continue to have a partial, limited and well defined exemption from Federal antitrust laws.

Senator **Metzenbaum**. Thank you very much, Mr. Randall. Mr. Randall, I have got just a couple of questions for you because you introduce a new factor into this debate that we have not previously had.

Your prepared statement describes a situation in which the insurer rather than the market determines the hourly labor rates and forces the shops to agree to charge those rates.

How does the insurance industry's control of auto repair rates affect the public?

Mr. **Randall**. Well, primarily, and there are examples in the attachments that we provided to you, they dominate the relationship, insisting on a mediocre or a commercially satisfactory repair, and in those instances they are willing only to pay a specific amount that they are negotiating or dictating to the shops.

The example that I have with me is a Mercedes in which they, for instance, said they would pay about $5,800 damage to this car. As it turned out, the damage was over $10,000 to that car.

Had the insured not been a prominent person of stature in the community, he would not have gotten that car completely repaired. He did get it repaired with the help of the shop and he did not suffer an economic loss. But all too often, the insured, who knows very little about the quality of the repair, takes the standard repair back and they get the car in an accelerated depreciated condition.

Senator **Metzenbaum**. If the antitrust exemption were repealed, the automotive service industry would be in a position to challenge the arbitrary rates presently being set by the industry?

Mr. **Randall**. We would. We are too small to do it individually, but I think we could get the Federal Government possibly to bring the suits or collectively we might be able to challenge them.

The main thing is if they were competing in writing the policies so that they compete in the claims settlement system. There is only one company, and only recently have they put into their policies language that is clear or slightly clearer and not quite as ambiguous as their previous policy, and that is State Farm.

The other companies write their policies in an indefinite, vague way. They can then control the claims settlement procedure. They do not compete in claims settlements.

Senator **Metzenbaum**. Do insurers or industry organizations get together now and agree on claims settlement terms in standard insurance policies?

Mr. **Randall**. We do not have any hard evidence, Senator. Horizontal combinations or conspiracies between them—we know that they on an hourly and daily basis they subrogate claims among themselves. They tend to lock-step and follow a uniform procedure.

For instance, in a given area they may agree to pay only $25 per hour to repair any car, whether it be a Mercedes or a BMW that costs $60,000 or a Pinto that costs $7,000. In fact, I have another attachment from a doctor here whose car was subjected to this kind of an affair and he, in fact, said when his patients come in, if they have a problem he chooses a neurosurgeon if that is what is needed or he chooses the appropriate repair facility for the human being that can accomplish the job with the right tools and skills. That is not true in the auto repair industry.

Senator **Metzenbaum**. I want to thank this panel. Your testimony is very helpful. I am hopeful that each of you will speak with some of the Senators who have not yet used the good judgment to become cosponsors. We welcome them. We welcome your help and look forward to working with you.

The hearing stands adjourned.

[Whereupon, at 12:15 p.m., the committee was adjourned.]

APPENDIX

TESTIMONY

OF

THE ASSOCIATION OF AMERICAN PHYSICIANS
AND SURGEONS, INC.

BEFORE

THE COMMITTEE OF THE JUDICIARY SUBCOMMITTEE
ON ANTITRUST AND MONOPOLIES
UNITED STATES SENATE

DELIVERED BY

KENT MASTERSON BROWN
GENERAL COUNSEL

WASHINGTON, D.C.

JUNE 2, 1987

Senator Metzenbaum;
Members of the Antitrust Subcommittee
of the Senate Judiciary Committee;

I. INTRODUCTION

I, first of all, want to extend to the Subcommittee, and to you, Senator Metzenbaum, the sincere appreciation of the Association of American Physicians and Surgeons for the invitation extended to it to appear and testify today. It is an honor and a privilege, indeed.

The Association of American Physicians and Surgeons heartily supports the enactment of S1299, the bill which, if enacted, will repeal the McCarran - Ferguson Act.[1]

For more than six (6) years, the Association of American Physicians and Suregons (AAPS) has campaigned for the repeal of the McCarran-Ferguson Act. The Asscoiation is now, and has been, of the opinion that the repeal of McCarran-Ferguson is essential to any successful attack upon the spiraling cost of health care and the host of individual problems which contribute to and are attendant to increasing health care costs. The cost of medical malpracice insurance and the techniques by which that insurance product is marketed; the division of insurance markets; the review of health insurance claims; the marketing of health insurance products through the organization and aggregation of health care providers and the cost and marketing of health insurance products remain issues of concern which are difficult to address without insurance industry responsibility under the nation's antitrust laws.

1 McCarran - Ferguson Act.
15 U.S.C. §1011-15; See specifically 15 U.S.C. §1012 and 1013 which read:

§1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) State regulation. The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation of taxation of such business.

(b) Federal regulation. No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Shermn Act [15 USCS §§1, et seq.], and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 USCS §§41, et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State law. (Mar. 9, 1945, ch 20, §2, 59 Stat. 34; July 25, 1947, ch 326, 61 Stat. 448.)

§1013. Suspension until June 30, 1948, of application of certain Federal laws; Sherman Act [15 USCS §§ 1 et seq.] applicable to agreements to, or acts of, boycott, coercion, or intimidation

(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act [15 USCS §§1, et seq.], and the Act of October 15, 1914, as amended, known as the Clayton Act and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 USCS §§ 41 et seq.], and the Act of June 19, 1936, known as the Robinson-Patman Antidiscrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this Act [15 USCS §§1011 et seq.] shall render the aid Sherman Act [15 USCS §§1 et seq.] inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation. (Mar. 9, 1945, ch 20, §3, 59 Stat. 34; July 25, 1947, ch 326, 61 Stat. 448.)

The Sherman Act
15 USCS §1 reads as follows:

§1. Trusts, etc., in restraint of trade illegal; penalty
Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by the fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

(July 2, 1980, ch 647, §1, 26 Stat. 209; Aug. 17, 1937, ch 690, Title VIII, §1, 50 Stat. 693; July 7, 1955, ch 281, 69 Stat. 282; Dec. 21, 1974, P.L. 93-528, §3, 88 Stat. 1708; Dec. 12, 1975, P.L. 94-145, §2, 89 Stat. 801.)

15 U.S.C. §2 reads as follows:

§2. Monopolizing trade a felony; penalty

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

(July 2, 1890, ch 647, §2, 26 Stat. 209; July 7, 1955, ch 281, 69 Stat. 282; Dec. 21, 1974, P.L. 93-528, §3, 88 Stat. 1708.)

The Clayton Act
15 U.S.C. §15 reads as follows:

§15. Suits by persons injured

(a) Amount of recovery; prejudgment interest. Execpt as provided in subsection (b) any person who shall be injured in his business or property by reason of anything forbidden in the antiturst laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee. The court may award under this section, pursuant to a motion by such person promptly made, simple interest on actual damages for the period beginning on the date of service fo such person's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, or for any shorter period therein. If the ocurt finds that the award of such interest for such period is just in the circumstances. In determining whether an award of interest under this section for any period is just in the circumstances, the court shall consider only -

(1) whether such person or the opposing party, or either party's representative, made motions or asserted claims or defenses so lacking in merit as to show that such party or representative acted intentionally for delay, or to otherwise acted in bad faith;

(2) whether, in the course of the action involved, such person or the opposing party, or either party's representative, violated any applicable rule, statute, or court order providing for sanctions for dilatory behavior or otherwise providing for expeditious proceedings; and

(3)whether such person or the opposing party, or either party's representative, engaged in conduct primarily for the purpose of delaying the litigation or increasing the cost thereof.

It need not be restated here that the concerns of the insurance industry expressed before this Congress in 1945 after the Supreme Court of the United States handed down its opinion in United States v. Southeastern Underwriters Association, 322 U.S. 533 (1944) do not exist today.[2] It is frankly doubtful that conditions ever existed to warrant the exemption from the antitrust laws for the insurance industry brought about by the passage of the McCarran - Ferguson Act.[3]

The presence of McCarran-Ferguson is particularly troublesome to the health care industry. Such is so because of the total dominance of what are called "third parties", or, insurers, in the payment - and, in many respects, the delivery - of virtually all health care services.

The phenomenon of insurance covering virtually all of a citizen's health care needs is one which developed in the years after 1945 to such an extent that it is now - for better or worse - an accepted fact of life. Likewise, since the mid 1970's, medical liability insurance for physicians has ceased to be simply "desirable"; it is now a "condition" of one practicing medicine just as surely as a degree from an accredited medical school. Acquisition of equipment in hospitals and medical offices, and, the manner of health care service delivery is, in some measure, insurance company-dictated. The delivery of health care services, consequently, is now, in large part, dependant upon insurance and insurers.

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[2] Up to the time the Supreme Court of the United States handed down its decision in Southeastern Underwriters, insurance had not been found to be interstate commerce for purposes of the Sherman Act. Paul v. Virginia, 75 U.S. (8 Wall) 168 (1869)

[3] See: Weller, "The McCarran - Ferguson Act's Antitrust Exemption for Insurance: Language, History and Policy", 1978 Duke L.J. 587 and, for an overview of the antitrust law relative to health insurers, see: Heitler, G., "Antitrust and Third-Party Insurers", 8 American Journal of Law & Medicine 251 (Fall, 1982)

Further, as noted by the distinguished legal scholar, Clark C. Havighurst, of Duke University School of Law, the predominance of certain insurance reimbursement mechanisms in the health care industry has utterly weakened normal economic forces which might, otherwise, operate to hold down increased health costs. The prevalence of insurance reimbursement schemes to pay for health care services that are tied to "uniform, customary and reasonable" fees, or, predicated upon cost reimbursement has further distorted the problem.[4]

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[4] Inflation, on the whole, seems to have been arrested recently. However, one index continues to soar: health care costs. During 1983 the general inflation index rose a mere 3.8%, while doctors' fees and daily hospital room rates increased 7.5% and 9.3%, respectively. The leading cause of such inflation in health care is the method by which it is financed. Health care, unlike any other service provided or product manufactured in the United States, is almost entirely paid for by what are called "third-party payers" - insurance companies, government (through insurance companies), Blue Cross Blue Shield-type subscription plans, and self-funded employers. Rarely are health care services paid for entirely, or even largely, by the patient.

It is near given today that a health care bill is always paid. Though a startling fact in itself, the fact that health care bills are nearly always paid is even more astounding when one considers that the seller of the service -- the provider -- is the total price establisher. Third-party payers have historically paid the "usual, customary and reasonable" (U.C.R.) fee for medical, surgical and hospital services. That U.C.R. fee, of course, is set by

Naturally, in such a business environment, fertile fields exist for the perpetration of wrongs addressed in the federal antiturst laws by those who market insurance products and pay insurance claims. And, their decisions - every one of them - vitally affect what consumers ultimately pay for health care services.

Where the presence of insurance has became more and more a condition of the delivery of health care services and, for that matter, receiving health care services, the insurance industry has become the single most important decision maker in the health care delivery system, and, undoubtedly, as a result, the single largest aggregator of capital within the health care delivery system. That salient fact becomes alarming when one stops to

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the providers. The insurer then pays a percentage of the "U.C.R." fee. Not only do the providers, or sellers, establish price in this perculiar market, they fundamentally are able to enforce it through thrid-party payer-sanctioned insurance caims peer review activities in the relevant state and county medical societies. Kalstrom, "Health Care Cost Constrol by Third Party Payers: Fee Schedules and the Sherman Act", 1978 Duke L.J. 645 (1978) Lee & Hadley, "Physicians' Fees and Public Medical Care Program", 16(2) Health Services Research 185 (1981) Shostack, "Fee-for-Service Physician Payment: Analysis of Current Methods and their Development", 16(3) Inquiry 231, 234-36 (1979).

Third-party payers, being third-parties, have never shown an interest in cost containment. Rather, since they pass through the health case system the premium money of their so-called insureds or subscribers, third-party payers may actually show greater earnings in premiums, fees, etc., the more they "pass through" in claims. If such is true, it is a small wonder inflation is rampant in the health care delivery and financing system. Paranthetically, what is astounding to contemplate is that both the Medicare and Medicaid payment systems are designed after the Blue Cross Blue Shield, third-party payment model.

consider the billions and billions of dollars expended on health care services in the United States each year.

Consequently, among those industries in the United States which have aggregated the greatest amounts of capital, the life, health and casualty insurance industry ranks among the highest; possibly the highest. And, of course, that fact poses a more serious problem if the conduct of the insurance industry in the marketplace is left completely unpolicied.

The federal antitrust laws were drafted for many reasons, but one salient reason was best expressed by the late Mr. Justice Hugo Black when he wrote:

> The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic, political and social institutions.

Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 4-5 (1958).

The Association of American Physicians and Surgeons would like to point the subcommittee to certain facts that are present in the health care delivery system which indicate the need for insurance - industry responsibility under the federal antitrust laws.

II. THE MARKETING OF MEDICAL LIABILITY INSURANCE

Probably the most recurring - and most notable - problem in the health care delivery system is found in the marketing of medical liability insurance. Naturally, with the insurers screened from liability under the federal antitrust laws, there exists no authoritative information at hand in the form of case studies or judicial opinions illustrating anticompetitive behavior among medical liability carriers per se. The members of the Association of American Physicians and Surgeons, however, strongly believe that the medical liability insurance industry has engaged, and is engaging, in activities in the marketing of its products which, if scrutinized under the Sherman Act,[5] would be found offensive to its letter and spirit.

The health care industry, for the second time in eleven (11) years, is being informed by insurers that it is the subject of a "malpractice insurance crisis". Such occurred nationwide in 1975.[6] Then, as now, insurers withdrew from markets, elevated premiums and set about engaging in market conduct which, if found, in any other industry, would be deemed objectionable under the antitrust laws.

Among the principal means by which medical malpractice insurance companies market their products today may seriously involve the use of a practice which is referred to in antitrust parlance as a "tying arrangement". A "tying arrangement" has been defined as an agreement by one party to sell one product, but only on the condition that the buyer also purchases a different, or tied, product . . ." See: Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 5-6 (1958). For a "tying arrangement" to exist, the seller must have "control or dominance" over the product it sells in the market where the purchaser exists. Customarily, there exists in any given medical liability insurance market only one dominant producer or two dominant producers. If there is more than one, there seldom appears to be any serious competition for business. "Turf", somehow, seems protected and respected. Consequently, if a health care provider - a physician or hospital - cannot purchase medical malpractice insurance from the company in whose "turf" he or it provides health care services, he or it simply will remain uninsured.

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[5] 15 U.S.C. §§1,2 (See Footnote 1)

[6] State of Texas, Reaction to Crisis: A State By State Review of Medical Malpractice Legislation Enacted in 1975 (Austin, 1975)

Lack of medical liability insurance for a physician is a devastating problem. Universally, hospitals, as a result of insurance company pressures, require minimum amounts of medical liability insurance to be carried by every medical staff member as a condition of awarding privileges. Thus, a physician who cannot obtain medical liability insurance, simply cannot be credentialed in a hopsital, i.e. the physician cannot remain on the medical staff. Without hospital privileges, a physician [and there are a very few specialty exceptions] cannot practice his profession.

In recognition of the foregoing, medical malpractice insurance companies have become somewhat bold in their marketing techniques. In recent years it has become a common practice for a dominant insurance carrier to approach the administration of a hospital and inform it that it will not underwrite the hospital's liability unless the hospital makes the medical staff amend its bylaws to require each staff member to purchase medical liability policies of a certain face amount. Typically hospitals now require $1,000,000.00 per occurrance in coverage for a staff physician as a condition of awarding him or her privileges. The carrier, of course, recognizes that such a purchase customarily cannot be made of any other medical liability insurance product but the one it produces.

The foregoing marketing technique is commonplace in the medical malpractice insurance industry. Countless examples of such practices have been presented to this witness over the course of the last ten (10) years. Beyond a doubt, the technique is certainly suspect under the Sherman Act.

Where insurance markets appear divided by insurers, or, where, as in virtually every market for medical malpractice insurance, only one or two dominant carriers exist, and where medical liability insurance is withheld from a hospital unless its medical staff members are required by the hospital to purchase liability insurance policies of specified face amounts, an antitrust problem may well exist.[7]

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[7] Where a malpractice insurer offered its product only to members of a county medical association, such was found to be the "business of insurance" for purposes of McCarran - Ferguson and beyond the Sherman Act. Feinstein v. Nettleship Co. of Los Angeles, 714 F.2d 928, 1983-2 CCH Trade Cases ¶65,590 (9th Cir., 1983) The Feinstein case illustrates a close example of how the insurer's marketing of malpractice insurance can force physicians to join medical associations and make other decisions in their practices which will ultimately affect the delivery of

The Association of American Physicians and Surgeons well recognizes the potential danger of an uninsured physician operating in a hospital. But, given the fact that an insurer markets its products using such a technique, are not the doors open to potentially limitless abuse? The Associaiton of American Physicians and Surgeons strongly believes that the fact that insurers are not responsible under the antitrust laws because of McCarran - Ferguson allows such a practice to ripen and become more and more egregious. The insurer may arbitrarily inflate the cost of its product, and the provider would be utterly helpless in the protection of his or her practice. The provider may well be eliminated from the practice of medicine through such insurance marketing schemes.

Ultimately, not only the providers are injured, but the patients may lose a provider of their choice, and, naturally, with every increase in malpractice insurance costs - and with every loss of a provider of health care services - the cost of health care services increases to the patient.

Yet, how, given McCarran - Ferguson, can the problem be addressed or the facts even be discovered? Any private litigant suing under the Sherman and Clayton Antitrust Acts would face a jurisdictional challenge on the grounds of McCarran - Ferguson which would derail any fact-finding on the merits for years; and probably altogether. The costs of such litigation would be

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health care. Does not such conduct fit the definition of a "tying arrangement?"

prohibitive since the jurisdictional issue would likely be the subject of lengthy appeals.

III. THE PEER REVIEW OF INSURANCE CLAIMS

Peer review systems are pervalent in the health care industry. The members of the Association of American Physicians and Surgeons have always had a great respect for and interest in peer review, particularly that peer review which is conducted for purposes of enhancing the quality of medical care and the edification of health care providers.

However, in the past twenty (20) years, the peer review process has moved beyond the realm of quality review and into insurance "claims" review. The health insurance industry has long utilized the claims peer review process to reduce or defeat claims for health services presented to insurers for payment.

"Claims peer review" (CPR) is a mechanism whereby an insurance company has its claims reviewed by a committee of professionals for purposes of determing whether the company will pay the claim at all, or, pay another level payment.

Generally, in medicine, CPR committees are formed by the state medical associations and/or the county medical societies. For the most part, such committees are called "claims and utilization review committees." As a general rule, the constitutions and bylaws of the various state medical associations and county medical societies do not address either the formation of such committees or the functions of them. Though not in every instance, certainly in many instances, "claims and utilization review committees" are composed of members of the medical association or medical society appointed each year by the president thereof without regard to any constitutional or bylaw provision creating the committee.

In nearly every instance, these "claims and utilization review committees" have no rules or standards by which they are guided in deciding cases. The physician or surgeon whose patient's claims before the insurer are subject to a committee's review is afforded no protections once he is called to appear.

The insurance company which utilizes these committees usually has an agreement with the state or county medical association or society whereby it will forward to the medical association or medical society a stipulated sum of money - maybe $25.00 or $30.00 - for each case to cover the committee's "expenses". The insurance company customarily forwards a letter, accompanied by a copy of the physician's or surgeon's statement upon which the claim is based, to the "review" committee requesting its recommendation relative to whether the insurance company should pay the claim. The patient is usually not notified of any such "review" although he or she may ultimately bear the burden of the decision. The physician or surgeon whose claim is to be "reviewed" is notified by letter from the chairman of the "claims and utilization review committee" of the pending "review" of his fees charged in the claim, and is requested to attend a scheduled meeting of the committee.

At the committee meeting the insurance company may send its representative. When the subject physician or surgeon enters the conference room where the committee meets he is faced by between ten (10) and twenty (20) of his fellow physicians and/or surgeons, and maybe, the insurance company representataive. From that moment forward, the process has no order. The physician or surgeon whose claim is the subject of the "review" is subjected to wide-ranging and often embarrassing questioning. No "standard" fees are discussed. The committee members may not even have among their membership a physician or surgeon of the specialty of the subject physician or surgeon, or a member from the region of the state where the subject physician or surgeon practices. In almost every instance there is nothing more to guide the "claims and utilization review committee than the subject physician's or surgeon's statement. Diagnosis, history of the patient, prognosis of the malady, and treatment are treated summarily. The peculiar circumstances of each individual patient whose diagnosis and treatment is discussed seems, in most claims peer review settings, to be less than relevant. The patient is not present. No written findings of fact are prepared.

In the end, after an unstructured and sometimes rambling and accusatorial, committee-weighted "dialogue," the meeting concludes. If the decision is not announced immediately - and it seldom is - the subject physician or surgeon will receive a letter from the committee wherein it will announce that it has made a "recommendation" to the insurance carrier. In most instances, the committee recommends a reduced fee or that the fee not be paid at all. That recommendation for a reduction in fees is always followed by the insurance company. It, in turn, writes to its insured or subscriber that, based upon the claims committee's recommendation, and that the claim will not be paid in part or in whole. The patient, of course, is responsible for the balance due.[8]

Throughout this so-called "review" process no transcript of evidence is maintained; no minutes are taken; and no rules are followed. The committee hears no "evidence" in the formal sense. The physician or surgeon is never apprised of any standards or norms which determine the level of fees.

At the conclusion of the meeting, the physician and/or surgeon members of the CPR committee determine, for all practical purposes, the fee amount which a fellow physician's or surgeon's patient will be reimbursed. The committee "fixes" the price of delivery of health care services.

The foregoing description of the CPR is a generalized one to be sure. It does present, however, in general terms, the process of CPR as found in medicine as well as in the chiropractic, podiatric, dental and optometric fields.[9]

When one totals the thousands of "reviews" being conducted each month by state and county medical associations and societies and chiropractic, dental, podiatric, and optometric associations for insurance companies, it must be readily acknowledged that a significant portion of the health care dollar spent in the United States is being affected by the claims "review" process.

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[8] For a description of CPR see, Pollard, M.R., Leibenluft, R.L., Antitrust and the Health Professions, (July, 1981) pp 64-65 and see Kallstrom, "Health Care Cost Control by Third Party Payers: Fee Schedules and the Sherman Act", 1978 Duke L.J. 645 (1978)

[9] Havinghurst, C., "Antitrust Enforcement in the Medical Services Industry: What does it All Mean?" 58(1) Milbank Memorial Fund Quarterly, 89 (1980)

Of concern to the members of the AAPS is the potential anti-competitive nature of CPR, and the fact that it has been the subject of abuse. Certain physicians or alternative providers, for no legitimate reason, may be singled out or "red-flagged" for frequent review. Importantly, with large insurance programs which invite physician "participation", such as Blue Cross Blue Shield plans, the peer review of insurance claims provides a means of forcing the physicians to "participate", or suffer frequent "review", or, forcing the physicians to provide only certain means of treatment.[10] The directorships of the Blue Cross Blue Shield companies and the very committees performing claims review may even have one or more of the same physician members. Review may also be prompted by the members of the county or state associations or societies themselves for a variety of anticompetitive reasons.

No state in the Union has ever sought to regulate, by the legislation or otherwise, the CPR process. Instead, CPR is entirely un-policed. The course of conduct of each committee is determined by the committee upon each claim reviewed or by the association or society of which it is a part.

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[10] Peer review of insurance claims may well involve the same sort of unlawful boycott of alternative health care methodologies found in the landmark antitrust decisions of Blue Shield of Virginia v. McCready, 457 U.S. 465 (1982) (agreement between psychiatrists and insurer to deny insurance reimbursement to licensed psychologists) and Ballard v. Blue Shield, 543 F.2d 1075 (4th Cir., 1976) (agreement between medical doctors, their association and insurer to deny insurance reimbursement to licensed chiropractors)

CPR is not the same peer review which is conducted for the edification of the members of the profession. CPR does not focus on the quality of care. Unlike in-hospital peer review, claims peer review is not the retrospective examination of the clinical application of medical knowledge. Instead, it is an unstructured, arbitrary and nonrational method of allowing a physician's competitiors to set the level of his fees and a method of allowing insurance companies to defeat health care claims without regard to any previously-announced standards, norms or criteria.

Law suits filed by health care providers challenging such claims peer review activities were defended by insurance carriers as representing exempt activities for purposes of the McCarran - Ferguson Act. See: Bartholomew v. Virginia Chiropractors Association, 612 F.2d 812 (1979); Union Labor Life Insurance Company v. Pireno, 458 U.S. 119 (1982)[11] Ultimately, the Supreme Court of the United States ruled that such activities were not the business of insurance for purposes of the McCarran - Ferguson exemption. Wrote the Court, through Mr. Justice William Brennan:

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[11] The Association of American Physicians and Surgeons filed a brief amicus curiae before the Supreme Court of the United States in support of Dr. Alexander Pireno in Union Labor Life Insurance Co. v. Pireno, 458 U.S. 119 (1982)

> Arrangements between insurance companies and parties outside the insurance industry can hardly be said to lie at the center of that legislative concern [to protect intra-industry cooperation]. More importantly such arrangements may prove contrary to the spirit as well as the letter of §2(b), because they have the potential to restrain competition in non-insurance markets. Indeed, the peer review practices challenged in the present case assertedly realize precisely this potential; Respondent's claim is that the practices restrain competition in a provider market . . . rather than in an insurance market.

Union Labor Life Insurance Co. v. Pireno, 458 U.S. 119, 133-134.

Though the opinion of the Supreme Court of the United States in Pireno certainly slowed the process of claims peer review, it did not end it, and the process remains a common practice in the health insurance industry once again today, only it appears in somewhat more disguised forms.

Utilization and Quality Control Peer Review Organizations, also known as "PRO's", certified pursuant to 42 U.S.C. §1320c -1 et seq., as amended, to perform Medicare claims review, have been contracting out their peer review services today to private insurers and self-insured plans to perform CPR. The typical PRO is physician-incorporated and physician-owned, and it retains the services of local providers in the community to perform its review function. Commonly, it is a corporate creature formed by the state medical association. With PRO's all across the country, CPR for insurers is a lively and profitable business. The Association of American Physicians and Surgeons, importantly, does not assert herein that all CPR is violative of the Sherman Act. It, like Mr. Justice Brennan, asserts, instead, that CPR has the potential of being abused, and, in many instances, may well be an attempt by insurers to restrict competition in a non-insurance market [health care delivery] for their monetary gain. Certainly, CPR forms a convenient way to defeat health insurance claims and a means of undermining the practice of a health care provider.

It might be added here that, as a practical matter, nothing is more defeating to a physician's good name and reputation -and, consequently, his practice - than letters to his patients from insurers claiming that a claims and utilization review committee of the state medical association or county medical society, or a PRO, has determined that it should not pay for his health care service.[12]

To attack a claims and utilization review committee or a PRO for CPR would, naturally, invite a McCarran -Ferguson jurisdictional defense in spite of Union Labor Life Insurance Company v. Pireno. Again, for a private physician to raise a challenge under the Sherman and Clayton Antitrust Acts would be prohibitive in cost. The jurisidictional challenge would, in expense alone, crush all efforts at fact-finding.

IV. THE FORMULATION OF PPOs

Increased health care costs proportedly have led to the formulation of alternative payment methods for health care delivery. One such alternative, the preferred provider organization (PPO), is receiving wide publicity. Preferred provider organizations are presented by their promoters as cost-savings devices. Many health care providers have faced and are now facing,-the dilemma of choosing whether or not to join a PPO. The public hears that these devices are cost-saving, but most health care providers hear that they are simply necessary for economic survival. It is critical to understand that preferred provider organizations are largely insurance industry-created, promoted and sponsored. In every case, successful PPOs are dependant upon contracts with large insurers or self insured plans to make them profitable.

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[12] The FTC has, most recently, expressed similar concerns regarding CPR. See: Remarks of Acting Chairman Terry Calvani (FTC) of February 20, 1986 before American Bar Association's Joint Program on Antitrust Issues in the Health Care Industry. 5 CCH Trade Reg. Rptr. ¶50,479

In the recent United States Supreme Court decision of Arizona v. Maricopa County Medical Society, 457 U.S. 332 (1982, a medical society formed two foundations which were designed to aggregate health care providers in two Arizona counties for the purpose of offering their health care services at fixed, maximum fees according to a fee schedule. The two foundations entered into agreements with health insurance companies for the purpose of offering the services of those horizontally - aggregated providers to the insureds and subscribers of the contracting insurers. The membership in one of the foundations constituted seventy percent (70%) of the practitioners in Pima County, Arizona, alone. In a four to three decision, the Supreme Court held that the foundations' maximum fee-setting arrangements were per se illegal price fixing in violation of Section 1 of the Sherman Act.

To understand the rationale of the Supreme Court in Arizona v. Maricopa County Medical Society, and the impact of that decision on the changing health care delivery market, requires an understanding of the health care market and PPOs in their profusion of forms. Preferred provider organizations appear today in a wide variety of forms.

The typical PPO is analogous to the foundations created by the Maricopa County Medical Society, and hence is referred to as the "Maricopa" -type PPO. To create such a PPO, individual providers associate, creating an entity, which contracts with insurance companies. The PPO sets fees and disburses funds paid by the insurance companies to member-providers for their services rendered. The fees are "set" through the use of fee schedules and stipulated "conversion factors" for all relevant specialties. Fees are "policed" by Utilization Review or CPR committees. It is important to understand that the provider members of the "Maricopa" - type PPO continue to practice as individual competitiors. They aggregage for the purposes of, inter alia, having insureds or subscribers referred to them by the contracting insurance companies and, in turn, referring insureds or subscribers of insurers to one another; establishing price; and, receiving payment for the services rendered.

The Supreme Court of the United States held such an aggregation in the "Maricopa" - type PPO to be "horizontal" between "individual practitioners who compete with one another for patients", and, accordingly, a per se violation of Section 1 of the Sherman Act even though it comprised an attempt to set maximum, not minimum, fees.

Another type of PPO is one wherein the health insurance company solicits health care providers on an individual basis, without the individual providers necessarily knowing which provider is involved with the plan. Such an arrangement does not maintain the same posture in the law as the horizontal agreement in Arizona v. Maricopa County Medical Society, and thus would unquestionably pass muster under Section 1 of the Sherman Act.

Although this type of PPO, most likely, does not violate Section 1 of the Sherman Act, there is a possible conflict with Section 2 of the Sherman Act. The cause for concern arises from the growth of participation in the PPO. As provider participation increases, as it inevitably does and is designed to do, the market share necessarily grows with it.

Unlike Section 1 cases, Section 2 cases are not subject to a per se analysis as used in Arizona v. Maricopa County Medical Society. A court must, instead, examine, by facts, every aspect of the PPO to determine whether a monopoly exists in a relevant market. "Substantial dominance" of the relevant market, "power to control prices" or the "power to exclude or restrain competition" are the determinants. For third-party payers in health care, monopoly power has been determined to exist only when it possesses the "power to exclude competition" in a relevant market. Where the insurer controls less than 50% of the market, and other carriers control relatively significant percentages, there may be no monopoly.[13]

Yet another PPO is the hospital-based organization. No case dealing with antitrust implications of such a PPO has been litigated to date. In the hospital-based PPO, the hospital serves as the administrator of payments much like the organization formed by the physicians in Arizona v. Maricopa County Medical Society. The PPO participants are members of the medical staff; all individual, competing providers. Potentially, a hospital-based PPO violates Section 1 and 2 of the Sherman Act. The potential violation depends on the structure and conduct of the PPO.

Section 1 of the Sherman Act prohibits combinations in restraint of trade. If the hospital-based PPO involves a participation agreement between competing providers, it would constitute a horizontal agreement. Horizontal agreements of this type would be subject to the Arizona v. Maricopa County Medical Society analysis. Furthermore, an even more egregious violation occurs should the medical staff participate in any fee-setting process. Such could be characterized as price fixing, thereby subjecting the hospital-based PPO to the per se analysis used in Arizona v. Maricopa County Medical Society.

Additionally, the hospital-based PPO potentialy violates Section 2 of the Sherman Act by monopolizing the relevant market.

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[13] For a recent analysis of the effects of an insurer's "participatory" PPO under Section 2, see: Ball Memorial Hospital, Inc. v. Mutual Hospital Insurance, Inc., 603 F.Supp. 1077 (D.C. Ind., 1985) Aff'd F.2d (7th Cir.., 1986)

The potential conflict with Section 2 is obvious when there is only one hospital in a given community or market. When several provider hospitals are in a community, a violation is not as clear. If the relevant market is successfully defined as the hospital itself, then the potential Section 2 violation is more easily established since the hospital would comprise 100% of the relevant market. If the relevant market is broader, not narrowly confined to the hospital, then the potential violation depends on the facts regarding market dominance by the hospital.

In terms of the "Maricopa" - type PPO and the hospital-based PPO, an analysis cannot end with an examination of the market effects of the provider -- or seller -- aggregation. In both forms one must examine the market influence of the aggregation of contracting, third-party payers. Purchasers of health care services may restrain trade as a readily as sellers of health care services. Thus, an aggregation of health insurance entities may invoke a Section 1 proscription if sufficient market effects can be shown. Such a combination in restraint of trade among "purchasers" would be known as a "monopsony".

It must also be understood in all of the foregoing analysis that the ability the sellers or purchasers to actually "control the market" or "control prices" makes no difference in analyzing any agreement to fix prices. As noted by the Supreme Court of the United States in United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224, 60 S.Ct. 811, 845, n. 59 (1940),

> Price fixing agreements may or may not be aimed at complete elimination of price competition. The group

> making those agreements may or may not have power to control the market. But the fact that the group cannot control the market prices does not necessarily mean that the agreement as to prices has no utility to the members of the combination. The effectiveness of price-fixing agreements is dependent on many factors, such as competitive tactics, position in the industry, the formula underlying price policies. Whatever econcomic justification particular price-fixing agreements may be thought to have, the law does not permit an inquiry into their reasonableness. They are all banned because of their actual or potential threat to the central nervous system of the economy.

In summary, the Supreme Court of the United States in Arizona v. Maricopa County Medical Society opened PPOs to antitrust scrutiny. No longer is the lack of judicial experience with antitrust in the health care industry a viable argument. PPOs may pose serious, potential antitrust problems, and they may be subject to liability along with physician and hospital providers unless a cautious approach is followed in their creation and administration.

It is important to emphasize here that the Association of American Physicians and Surgeons does not raise the potential antitrust consequences of PPOs here becasue it believes them to be universally harmful. On the contrary, PPOs may form a legitimate answer to certain health care cost problems and may, in fact, heighten competition. But, as evidenced in the case of Arizona v. Maricopa County Medical Society, a PPO may also enforce a price restraint

> . . . that tends to provide the same economic rewards to all practitioners regardless of their skill, their experience, their training or their willingness to employ innovative and difficult procedures in individual cases. Such a restraint also may discourage entry into the market and may deter experimentation and new developments by individual intrepreneurs. It may

> also be a masquerade for an agreement to fix uniform prices, or it may in the future take on that character.

Arizona v. Maricopa County Medical Society, 457 U.S. 332, 348.

The fears of Mr. Justine Brennan have not proven to be idle ones. Not only did the State of Arizona move against the Maricopa County Medical Society for the Maricopa and Pima Counties PPO, but state attorneys general and the United States Department of Justice have moved against subsequently-established preferred provider organizations which were formed for the very purpose of eliminating other providers from competition! Washington v. Clallam County Physicians Service, Inc., 48 BNA Antitrust & Trade Reg. Rept. 512 (Wash. Super. Ct. 1985); Washington v. Snohomish County Physicians Corp., 1985-1 Trade Cases (CCH) ¶66,504 (Wash. Super. Ct. 1985) and see: United States v. Halifax Hospital Medical Center, 1985-1 Trade Cases, (CCH) ¶66,426 (M.D. Fla., 1980).

The concerns of the Association of American Phyisicians and Surgeons are best summarized by acting Chairman Terry Calvani of the Federal Trade Commission in his remarks delivered on February 20, 1986 before the American Bar Association's Joint Program on Antitrust Issues in the Health Care Industry,

> . . . the Commission is also interested in assuring that PPOs do not serve as a vehicle for price fixing among the participating doctors. In fact, it was this aspect of a PPO (or a PPO-like organization) that was condemned by the Supreme Court in the Maricopa case. The variety of PPOs is too great to allow for firm and simple rules here. As a general proposition, however, the risk of antitrust problems will tend to increase to the extent the PPO is controlled by competing doctors rather than by employers or insurers, to the extent it does not involve any functional marketing

> integration, to the extent it does not allow its member doctors to contract with any other PPO, and to the extent that it does embrace a large proportion of the doctors in the community.

5 CCH Trade Reg. Rptr. ¶50,479[14]

Simple physician-created PPOs most likely cannot claim the McCarran - Ferguson exemption, although there does exist the argument for such an exemption, particularly where the PPO promotes capitation payment. Such a capitation payment scheme necessarily makes the PPO assume the risk of providing the health care needs of the consumer-members. Such may well exempt the PPO from antiturst liability under McCarran - Ferguson.

Most PPOs, however, are insurance company-created and sponsored. The claims review performed is for the benefit of the insurance carrier. Naturally, McCarran - Ferguson forms a barrier against antitrust attack by those whose practices may be unfairly injured due to PPO pricing and referral conduct. Any physician injured by price-fixing schemes or referral schemes of a particularly potent insurer in the market will face an enormously expensive jurisdictional challenge due to the pressure of McCarran - Ferguson.[15]

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[14] The Federal Trade Commission recognizing the enormous possibility for anticompetitive behavior by PPOs - and IPA/HMOS for that matter - has periodically issued guidelines to promoters. See: Letters from Arthur V. Lerner, Ass't. Dir., Bureau of Competition, FTC to Gilbert M. Primet, No. 840002 (¶22,036 22,641 (June 8, 1983) (FTC Advisory Opinion to Health Care Management Associates)

[15] That PPOs would seek protection under McCarran - Ferguson does, indeed, have legal support. Group Life & Health Ins. Co. v. Royal Drug, 440 U.S. 205 (1979) See: Batavia, A.I., "Preferred Provider Organizations: Antitrust Aspects and Implications for the Hospital Industry" 10 American Journal of Law & Medicine 151, 1860187 (Summer, 1984); Comment.

V. CONCLUSION

To conclude, the Association of American Physicians and Surgeons strongly believes that repeal of the McCarran - Ferguson Act is essential to the addressing of the ills of the health care industry. To be sure, though, the Association of American Physicians and Surgeons does not favor the "federalizing" of the insurance industry, and any such results of the repeal of McCarran - Ferguson would be deleterious to the health care industry, and the nation. Consequently, with that one strong reservation - in which the Associaiton is joined by other witnesses such as the United States Department of Justice - the Association of American Physicians and Surgeons whole-heartedly endorses the enactment of S. 1299 and the repeal of the McCarran -Ferguson Act.

Thank you.

KENT MASTERSON BROWN
General Counsel
AAPS

June 2, 1987

"The Scope of the 'Business of Insurance' provision of the McCarran - Ferguson Act: Virginia Academy of Clinical Psychologists v. Blue Shield of Va.", 65 Minn L. Rev 1187 (1981); For further discussion, see: Cowan, D.H., Preferred Provider Organizations (Rockville: 1984) pp. 223-227

STATEMENT

OF

THE BLUE CROSS
AND BLUE SHIELD
ASSOCIATION

CONCERNING THE McCARRAN-FERGUSON ACT

This statement is submitted by the Blue Cross and Blue Shield Association on behalf of its 77 Member Plans throughout the United States. Blue Cross and Blue Shield Plans are not-for-profit corporations. Together they service approximately 100 million people in private and governmental health care programs.

We understand that the purpose of this hearing is to examine the McCarran-Ferguson Act. This law, passed in 1945, exempts from federal antitrust scrutiny activities that are within the "business of insurance," to the extent that they are regulated by state law and do not constitute acts of boycott, coercion or intimidation.

This statement undertakes to address the McCarran-Ferguson Act only in the context of the market for prepaid health care. The Association does not believe that there are widespread abuses in the health insurance market that would warrant repeal or significant amendment of the McCarran-Ferguson Act. We further believe that neither repeal of the McCarran-Ferguson Act nor the narrowing of its federal antitrust exemption would lower the cost or increase the availability of health care coverage; that repeal or amendment, as proposed by S. 1299, would disrupt the present system of state regulation of insurance; and that because the nature and extent of the exemption that the McCarran-Ferguson Act affords have been exaggerated, the effects of repeal on competition also have been overstated and overestimated. Finally, the Association believes that there are several sound reasons, including the need to contain health care costs, for retaining what is left of the antitrust exemption. Our reasons for these conclusions follow.

THE McCARRAN-FERGUSON ACT

Simply stated, the McCarran-Ferguson Act did three things.

First, it established as public policy that the states should regulate the insurance business and that no federal legislation should apply to insurance unless it was specifically mentioned in the legislation.

Second, it created a limited exemption from the federal antitrust laws, to the extent that the otherwise prohibited activities were (i) the "business of insurance," (ii) were regulated by state law, and (iii) were not acts of boycott, coercion or intimidation.

Third, Congress retained its power to pass specific legislation relating to insurance. Congress has exercised this power: ERISA, the Baucus Amendment dealing with private Medicare supplemental insurance, and the recent COBRA continuation of group health benefit requirement are but three examples of this kind of targeted federal intervention.

Immunity under the McCarran-Ferguson Act

There appears to be much confusion in the public dialogue concerning the extent to which the McCarran-Ferguson Act exempts the business of insurance from antitrust scrutiny. The Act is often described as conferring "blanket immunity." If this is so, then it is no more than a baby blanket. It is worth examining the scope of immunity that McCarran affords, in order to assess the effects of repeal.

First the McCarran-Ferguson Act affords no immunity from enforcement actions brought under state antitrust statutes. It deals with the federal antitrust laws only. Almost every state has its own body of antitrust legislation, most of which closely parallels the federal statutes.

Second, the immunity that the Act affords from federal antitrust law is significantly circumscribed both by the language of the McCarran-Ferguson Act itself and by judicial interpretation of it. The Act exempts from federal antitrust scrutiny activities that are (1) within the "business of insurance," (2) to the extent that they are regulated by state law, and (3) do not constitute acts of boycott, coercion or intimidation. These three limitations add up to significant antitrust exposure for insurers, as described below.

(i) Boycotts, Coercion and Intimidation

McCarran-Ferguson provides no shield from federal enforcement actions involving boycotts, coercion or intimidation. These three kinds of unlawful activity together constitute a significant portion of the total body of antitrust law.

(ii) The State Regulation Requirement

The McCarran-Ferguson exemption applies only where the conduct in question is regulated by state law. Insurers generally, and Blue Cross and Blue Shield Plans in particular, are subject to pervasive state regulation, and therefore do not operate in a laissez faire environment simply because certain limited activities are exempt from federal antitrust scrutiny.

(iii) The Business of Insurance Requirement

The McCarran-Ferguson Act exemption applies only to activities that are the "business of insurance." The McCarran-Ferguson Act provides no definition of the "business of insurance," but over the years the Supreme Court has supplied one, and it is suprisingly narrow. It in not synonymous with, nor coterminous with, the "business of insurers" (such as buying pencils or printing claim forms). There are three criteria relevant to determining whether a particular practice is the business of insurance: (a) whether the practice transfers or spreads risk; (b) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (c) whether the practice is limited to entities within the insurance industry.[1]

It has been difficult of late for insurers and the Blue Cross and Blue Shield organization to establish that their activities challenged on antitrust grounds are in fact the "business of insurance." For example, in the past few years, the following activities have been held to be not the business of insurance: (a) contracting with providers;[2] (b) refusing to pay for the services of clinical psychologists unless billed through a physician (the reimbursement terms did not affect benefits, but whom to pay);[3] (c) refusing to pay for the services of podiatrists (insufficient nexus to underwriting of risk);[4] and (d) conducting peer review.[5] Conversely, relatively few activities have been held to be the business of insurance. These include: (a) the refusal to cover chiropractic care (coverage or exclusion of specified services in a subscriber contract involved the spreading and underwriting of risk);[6] (b) a Plan requirement that married subscribers purchase family coverage (the extent of the coverage goes to "the heart of the relationship between an insurance company and its policyholders");[7] and (c) provisions of an insurance policy providing drug benefits only for prescriptions filled by certain pharmacies (this involved only the insurer and insureds).[8]

These case law definitions of the "business of insurance" clearly show that the business of insurance exemption of the McCarran-Ferguson Act is narrowly construed, and far from being a "blanket exemption."

Finally, McCarran-Ferguson provides no immunity from price fixing or allocation of territories. The proponents of repeal have often argued that the McCarran-Ferguson Act permits insurers to fix prices and to allocate territories in ways which, otherwise, would be illegal. There is little, if any, foundation for this position. First, there is no support for it in the language of the McCarran-Ferguson Act itself. Second, there are no decided cases that would support this position.[9] And third, in view of the Supreme Court's narrow interpretation of the "business of insurance," it is hard to see how the Act could conceivably protect such fixing of prices or allocation of territories by competitors.

The view that the McCarran-Ferguson Act does not shield price fixing was recently reinforced by a decision of an FTC Administrative Law Judge. In In re Ticor Title Insurance Co., et al., Initial Decision, Dkt. 9190 (January 6, 1987), CCH Trade Reg. Rep. ¶22,419, the judge ruled that five major national title insurance companies illegally combined to fix their prices for search and examination services through their participation in rating bureaus in Connecticut and Wisconsin. The judge found that joint ratemaking had "no connection whatever to risk spreading," and ordered the companies not to use rating bureaus in those two states in the future.

Availability of Coverage for Health Care Expenses

Some proponents believe that repeal would lower prices and increase the availability of coverage. They assume that the McCarran-Ferguson Act affords the insurance industry a "blanket exemption" from antitrust enforcement actions, that it permits insurers to fix prices, allocate territories and engage in other anticompetitive practices, and that this is what has created the current liability insurance "crisis." These assumptions concerning the McCarran-Ferguson Act exemption are incorrect as a matter of law, and the conclusions drawn therefrom -- insofar as they are based on false premises -- are nonsequiturs. There seems to be no reasoned analysis that causally connects the McCarran-Ferguson Act to the alleged crisis in liability insurance. Rather, there is much evidence to suggest that the real culprits are recent developments in tort law and litigation -- no-fault liability, increasing damage awards, costs and delays in litigation and the resulting pressure to settle suits. In any event, the notion that repealing the McCarran-Ferguson Act would lower prices and increase availability is at best conjectural.

Moreover, this argument fails to take into account the fact that the insurance industry -- property, casualty, life and health -- is inherently competitively structured, with hundreds of companies and low barriers to entry. This in itself is a formidable obstacle to collusive, anticompetitive behavior.

As for health insurance in particular, the increasing cost of health insurance is not the result of the McCarran-Ferguson Act. The causes are well documented elsewhere, and include such factors as changes in demography, increased technology, and the practice of defensive medicine.

State Regulation of Insurance

The Blue Cross and Blue Shield Association is concerned that the repeal or modification of the McCarran-Ferguson Act might (i) change the situs of insurance regulation -- from state to federal; or (ii) create a dual system of regulation. The former might be disruptive, the latter certainly would be dysfunctional and costly.

The proponents of repeal of the McCarran-Ferguson Act seem to assume that state regulation is inadequate and ineffective. As far as Blue Cross and Blue Shield Plans are concerned, however, it can be seen that this assumption does not apply. State regulation of Blue Cross and Blue Shield Plans pursuant to their state enabling legislation is quite stringent. For example, Plans in 16 states must obtain prior approval from the regulatory authority for their group rates or formulae, and many other states subject Plan rates to "file and use" requirements or to "deemer" periods of lengths varying from 15 to 60 days. Most states regulate the filing and approval of subscriber contracts and rates, reserve levels, application of other insurance laws and investment authority. Many states require that Plans file and obtain approval of provider contracts and provider payment rates, and in a significant number of jurisdictions, Plan expenses for administration and solicitation of subscribers are specifically subject to state approval or control. Many states regulate Plan board composition and board selection procedures, and all Plans are subject to periodic audits and examinations by state authorities.

Further, we believe that state regulation of health insurance is not only effective but appropriate because health insurance is essentially a uniquely local transaction reflecting the demographic, economic, social and geographic make-up of the region. Local regulators know those conditions and are in a better position to know and to assess the health care needs and resources of the community. Local regulators also have the means and greater incentive to regulate the market conduct of insurers. They also are better equipped to handle consumer inquiries and complaints and to respond to consumer demands. Retaining local oversight of local health care financing makes sense.

State regulation also permits diversity and experimentation. This in itself is procompetitive. No one state regulator can close off an experiment nationwide. These experiments involve new forms of provider contracting, new benefits, pricing, underwriting, marketing, and claims techniques, as well as experiments in regulation - all aimed at providing consumers with lower cost health care protection.

It is worth noting that state regulators freely exchange information and benefit from the experience of their peers through the National Association of Insurance Commissioners

(NAIC). NAIC is an important resource for state regulators. It provides a forum for consideration and discussion of the problems of the consumer, the industry and the regulator and performs valuable training, audit and data collection activities that benefit all state insurance regulators. The open involvement of the industry in the NAIC's deliberations has helped improve state regulation of insurance and strengthened the regulatory process.

State regulation of insurance continues at the discretion of Congress. That knowledge forces state regulators and the insurance industry to respond to legitimate criticism of the state regulatory system. Constant federal review of the McCarran-Ferguson Act has produced positive changes within the state regulatory system.

We also would submit that the cost implications for consumer/taxpayers support retention of the current system. Establishing the additional layer of federal bureaucracy that a system of dual federal/state regulation would require cannot be viewed as in the best interests of the public.

Effects of Repeal of the McCarran-Ferguson Act

We believe that repeal of the Act could trigger the passage of anticompetitive state legislation to create new "state action" exemptions.

The "state action" exemption from the antitrust laws provides, in essence, that the antitrust laws do not apply to activity that is (i) clearly articulated and affirmatively expressed as state policy, and (ii) actively supervised by the state.[10] Without the McCarran-Ferguson Act, therefore, certain activities of insurers might be immune only if they met the two criteria for state action. In some states, the present legislative and regulatory framework would satisfy the state action standard, and therefore repeal of the Act might have no effect. In other states, however, the regulatory framework might not satisfy the two-prong test, and here repeal might have the effect of creating a rush to the state legislatures to pass anticompetitive regulatory legislation. Consequently, over-regulation by states could dampen appropriate competition in the health care benefits market. Such competition serves to moderate benefit costs.

We further believe that health benefit costs could be increased if McCarran-Ferguson were to be repealed. Notwithstanding the existence of the McCarran-Ferguson Act, the supposed obstacle to antitrust enforcement, the Blue Cross and Blue Shield Association and Plans are the frequent and continuing target of antitrust plaintiffs, who are usually providers of health care rather than purchasers of coverage. The availability of the McCarran-Ferguson Act, with its "business of insurance" exemption as interpreted by the Supreme Court, enables such antitrust defendants to move to dismiss such litigation in its early stages, on the ground that the challenged activity is the business of insurance, is regulated by state law, and is not a boycott, coercion or intimidation. If the court grants such a motion to dismiss, and if this dismissal is upheld on appeal, the defendant is saved the time and expense of litigating the case through a trial on the merits. Retaining the McCarran-Ferguson Act, therefore, is an important cost containment device, since an antitrust trial, particularly one under the rule of reason, can be a severe financial drain.

It is well established that the market for health care financing is highly competitive. It is also well known that losers in the competitive arena frequently turn to antitrust to remedy their grievances -- hence many of the frivolous antitrust cases filed against the Blue Cross and Blue Shield organization. It is particularly important, from a cost standpoint, to be able to win such cases on motion practice, without the expense of a trial on the merits. In light of the Supreme Court's narrow definition of the "business of insurance," opportunities for such motion practice have diminished, but what remains is worth retaining, in the consumer's interest of using the consumer's health care dollar to purchase health care, rather than antitrust defense representation.

Conclusion

In conclusion, we believe that the McCarran-Ferguson Act should be retained. State regulation of health insurance has been and continues to be appropriate and cost-effective. Further, there is no indication of widespread antitrust abuses in the health care marketplace to warrant repeal or narrowing of the Act's limited antitrust exemption. In addition, repeal could be damaging to our already strained health care financing system by adding unnecessary and burdensome costs and by diminishing market competition that serves to contain overall health care costs.

FOOTNOTES

1. In *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), the Supreme Court supplied the rudiments of a definition of the "business of insurance" which the McCarran-Ferguson Act lacked:

   > The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement -- these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was -- it was on the relationship between the insurance company and the policyholder. *Id*. at 460.

   This language reinforced the Court's previous emphasis on the nexus between risk-taking or risk-shifting and the "business of insurance": "[Here], [t]here is no true underwriting of risks, the one earmark of insurance as it has commonly been conceived of in popular understanding and usage." *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 71 (1959). *See also.* *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *Union Labor Life Ins. Co. v. Pireno*, 102 S.Ct. 3002 (1982).

2. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *Portland Retail Druggists Ass'n v. Kaiser Foundation Health Plan*, 662 F.2d 641 (9th Cir. 1981); *Kartell v. Blue Shield of Massachusetts*, 749 F.2d (1st Cir. 1984).

3. Virginia Academy of Clinical Psychologists v. Blue Shield of Va., 624 F.2d 476 (4th Cir. 1980), cert. denied, 450 U.S. 916 (1981).

4. Hahn v. Oregon Physicians Service, 689 F.2d 870 (9th Cir. 1982).

5. Union Labor Life Ins. Co. v. Pireno, 102 S.Ct. 3002 (1982).

6. Health Care Equalization Committee v. Iowa Medical Soc'y, 501 F.Supp. 970 (S.D. Iowa 1980).

7. Anglin v. Blue Cross & Blue Shield of Va., 693 F.2d 315 (4th Cir. 1982).

8. Klamath-Lake Pharmaceutical Ass'n v. Klamath Medical Service Bureau, 701 F.2d 1276 (9th Cir. 1983), cert. denied, 464 U.S. 822 (1983).

9. Two cases, however, merit scrutiny. In Proctor v. State Farm Mutual Automobile Ins. Co., 675 F.2d 308 (1982), cert. denied, 103 S.Ct. 86 (1982), a divided D.C. Circuit held that an alleged horizontal agreement among insurance companies to fix the price for car repairs constituted the business of insurance. The court distinguished Royal Drug, noting that Royal Drug had concerned vertical agreements between a single insurer and providers, and that it had indicated that "horizontal, wholly intra-industry agreements should be analyzed differently." The D.C. Circuit stated: "It is fair to say that at least some horizontal agreements among insurers fall within the 'business of insurance' exemption, and that the tests in Royal Drug for determining what constitutes the 'business of insurance' are more easily satisfied by an intra-industry agreement than by a vertical agreement with an entity outside the insurance industry." It also found that this was consistent with the legislative history of the McCarran-Ferguson Act, because Congress had been concerned about exempting cooperative ratemaking and sharing of statistical data from antitrust attack. The alleged activity in this case -- the collection and sharing of data on the cost of repair and labor costs in particular, as well as an agreement on a prevailing hourly labor rate to be used in estimating damage claims -- "is closely akin to cooperative ratemaking since it involves a necessary part of the ratemaking process."

   The court recognized that "not everything that affects the level of premiums constitutes the 'business of insurance.'" However, the cost of repair "is directly related to the calculation of premiums; it is virtually a part of the ratemaking process. In short. . .the alleged horizontal agreement in this case is distinguishable from general cost-saving arrangements that are less directly related to the calculation of rates."

   Acknowledging that the alleged agreement to establish a common formula for estimating claims may not involve the spreading or underwriting of risk, the court again noted Royal Drug's failure to "make clear whether this is the exclusive or dispositive test for determining what constitutes the 'business of insurance.'" Royal Drug does not bar a court "from at least considering the close relationship between the subject of the challenged agreement and the calculation of rates in determining whether the agreement falls within the 'business of insurance.'"

   The court also noted that "the alleged agreement pertains to the adjusting and settling of claims, a practice traditionally regarded as part of the insurance business." The court disagreed with the Second Circuit's suggestion in

Pireno "that claims settlement should not be viewed as the 'business of insurance' after Royal Drug." This view, however, is no longer good law, in light of the Supreme Court's affirmance of Pireno, 102 S.Ct. 3002 (1982).

In Grant v. Erie Ins. Exchange, 542 F. Supp. 457 (M.D. Pa. 1982), a class of administrators of the estates of deceased motor vehicle accident victims alleged that 31 Pennsylvania insurance companies had conspired to refuse to offer insurance coverage with respect to work-loss benefits to the deceased victims, to not pay claims of such benefits, to conceal from potential claimants the right to bring such claims, and to provide a joint and uniform defense to claims for such benefits. The court held these activities to be exempt, noting that cooperative efforts by the insurance companies with respect to the collection of statistical data and ratemaking were part of the business of insurance because they concerned the interpretation and extent of coverage under Pennsylvania statute. The court held that the joint meetings between the companies to discuss common litigation strategy, the coordinating of defenses to prevent claimants from recovering work-loss benefits, and other combined efforts to avoid payment of work-loss benefits related to the interpretation and enforcement of the relationship between the insurer and insured. The alleged agreement or concerted action, the court held, involved the interpretation of statutory language concerning the scope and extent of work-loss benefits, and the attempts to obtain legislative and judicial approval of the companies' interpretation involved ratemaking, both of which were exempt from antitrust scrutiny and not concerted refusals to deal.

10. California Retail Liquor Dealers Ass'n v. Midcal Aluminum Co., 445 U.S. 97 (1980).

STATEMENT OF
THE CONSUMER BANKERS ASSOCIATION

The Consumer Bankers Association appreciates having the opportunity to present its views on the appropriateness of the continued exemption of the business of insurance from the Sherman and Clayton Acts. As we will describe, we believe that this exemption, insofar as it might permit price-fixing, is anti-competitive and anti-consumer and should be removed.

The Consumer Bankers Association ("CBA") is a nonprofit organization that was organized in 1919 to provide a voice for the consumer banking industry. Today, CBA membership, which totals approximately 700 institutions, is open to any federally insured depository institution, including commercial banks, savings and loans, credit unions and other providers of consumer financial services.

CBA's constituency primarily represents those divisions of depository institutions that provide products and services to individual consumers, rather than to corporations. This consumer banking focus enables CBA and its members to experience firsthand the needs and expectations of consumers.

Applying that focus, we believe that issues such as those being considered by the Subcommittee today must be viewed from a public policy perspective, not from the viewpoint of any affected industry. In measuring and shaping the rules that apply to a rapidly changing financial services industry, it is essential that the best interests of the consuming public serve as the exclusive frame of reference. CBA believes that federal anti-trust policies should apply to all that serve the public, absent some overwhelming demonstration that a business is so unique that the general pro-competitive policies reflected in federal anti-trust laws should not apply.

CBA believes strongly that such a showing cannot be made in connection with the current exemption from federal anti-trust rules insofar as they relate to the potential for price-fixing activities in the insurance business. In a free market, it is impossible to justify agreements among insurers to set rates in concert and anti-rebate laws that prohibit agents from negotiating commissions, thereby producing lower premiums for policyholders. Accordingly, CBA urges the Subcommittee to amend the McCarran-Ferguson Act to extend to the business of insurance the anti-price-fixing provisions of federal anti-trust statutes.

In doing so, CBA joins a growing number of groups supporting an amendment to the McCarran-Ferguson Act in order to eliminate the special protection afforded the business of insurance from the federal anti-trust laws. These include the Federal Trade Commission, the Department of Justice, the National Association of Attorneys General, the National Conference of State Legislatures, Consumers Union, the National Insurance Consumers Organization, the National Federation of Independent Business, the Small Business Legislative Counsel, the American Association of Retired Persons, and others.

We agree that anti-competitive, anti-consumer understandings among insurers to set rates should be prohibited and prosecuted under the anti-trust laws, just as is the case with price-fixing by any other business in this country. However, we believe that any amendment to the McCarran-Ferguson Act should not interfere with the right of the individual states to regulate and tax the business of insurance, particularly when those activities encourage and foster greater competition. The states also should continue to regulate insurance companies as they collect, pool, analyze and disseminate data on past claims paid in order to more accurately predict future payouts.

CBA's position is that the consumer and the national economy are both benefited by a reduction or elimination of anti-competitive barriers that inhibit free and open competition. We strongly oppose those barriers, whether they take the form of limitations on permitted activities, or the form of exceptions from pro-competitive rules and result in anti-competitive activity.

No one knows better than those in our industry of the frustrations and inefficiencies caused by anti-competitive measures. These inefficiencies, including an inability to sell a full range of insurance products, inevitably cost the consumer more and distort the sound workings of the market.

Under the current regulatory structure, the policies that undergird federal antitrust statutes are particularly important when considered in the context of the business of insurance. That is the case because the current, archaic regulatory structure effectively prevents full competition by precisely those potential new market entrants that are the most likely to enter the insurance business and that would provide the most effective competition. Accordingly, competition on the basis of price assumes unique significance.

Although we recognize that the matter under consideration by this Subcommittee does not extend to the structure of the financial services industry, we nonetheless believe that some discussion of this issue is pertinent, since it demonstrates the singular competitive function played by pricing in the business of insurance.

Despite dramatic changes in the financial landscape, markets remain artificially segmented by archaic distinctions that long ago lost their meaning. The laws that govern the financial services industry -- banks, thrift institutions, securities firms and insurance companies -- have not kept pace with marketplace changes and consumer demands. These laws are so seriously outmoded as to prevent the industries involved from efficiently meeting the needs and demands of consumers in particular and, thus, the marketplace in general. While there has been little significant change during the past fifty years in the legal structure that governs the financial services industry, over the same period much has changed in the areas of consumer need and expectations. Clearly, today's financial services consumers have vastly different needs than those of fifty years ago and all financial services providers should be permitted to meet those needs. Furthermore, the consumer is entitled to receive financial services at a reasonable cost -- not inflated by systemic inefficiencies and unproductive costs -- from providers who can offer a wide range of services and products.

Despite this anti-competitive structure that restrains certain financial services providers, a growing number of financial entities are providing products and services that traditionally have fallen outside of their own individual specialty area. These entities are permitted to cut across all product lines and engage in activities traditionally within the realm of financial services providers in other sectors. For example, insurance firms engage in securities, real estate, deposit-taking, lending and other financial-type activities. In commercial mortgage lending, four insurance-based companies make a greater volume of commercial mortgage loans than the fifteen largest bank holding companies and more than a quarter of the volume of all of the nation's banks. Insurance companies also have been permitted to acquire banks and other depository institutions, generally without legal obstruction.

While these expansions across traditional industry boundaries have permitted a growing integration of the products offered by financial services providers, statutory restrictions generally have prevented depository institutions from being able to provide a full range of insurance products. When competition is foreclosed, as it is now in the insurance business, existing product and service distribution channels are protected, resulting in higher prices and limited consumer options. A principal example is the excessive cost and inefficiency that exist in the current insurance distribution system.

It has been estimated that the independent agency distribution system costs consumers approximately $1 billion more annually than is necessary, due in large part to the fact that expenses are approximately twenty-one percent higher than when insurance is sold on a direct basis. For the insurance industry as a whole, commissions as a percent of premium income vary by product, ranging from less than nine percent for annuities to 19.4% for whole-life policies. In fact, the independent agent's commission on a whole-life insurance policy often is equivalent to the first year's premium. These statistics demonstrate that consumers are paying much more than is necessary in order to get the same insurance coverage that they could get if the number of market participants were expanded.

This competitive environment is directly relevant to the Subcommittee's deliberations, because it places added focus on the fact that a highly protected industry sector, safe from competitive forces competing with it on a specific product basis, has absolutely no market constraints in setting prices. Freed from the discipline of the market in terms of the entry of additional market participants, only by such price competition as may be available intra-industry is there any possible basis on which to allow market forces to work. Thus, the distortions caused by historical industry segmentation are amplified many times over when it is possible to anchor in a safe harbor free of concerns about price-fixing and other anti-competitive activities. Only by prohibiting pricefixing can even this limited form of market discipline be brought to bear.

At the very least anti-competitive policies should be removed so as to ensure that the limited market participants must play fair in selling their products, absent effective competition that would be made available if the current regulatory structures were modified to reflect current realities. A system that allows price fixing by a small number of providers is particularly repugnant in our economic system.

We believe that free and open competition -- both through pricing and ease of market entry -- is the proper objective in working to develop a financial regulatory structure that will best and most efficiently serve the consuming public. We should note that this reflects CBA's view irrespective of the way in which it affects industry. Thus, we would welcome into the depository business current securities and insurance players, so long as they were subject to the same rules to which we are subject and so long as we could enter their arenas under their rules. Any steps, whether at the state or the federal levels, to increase competition and to end artificial anti-competitive statutory and regulatory barriers -- again, whether through increased competition or the alleviation of anti-competitive practices, such as price-fixing -- will be strongly supported by CBA. In achieving that ultimate objective, a critically important step would be to remove the exemption that permits price-fixing that now is given to the business of insurance by the McCarran-Ferguson Act.

In conclusion, The Consumer Bankers Association supports open market competition among all types of financial institutions, both on the basis of ease of market entry and on free competition based on price and service. Antiquated laws that restrict competition should be changed to permit more participants. Until full market entry is permitted, at the very least the pro-competitive policies of the federal anti-trust laws should be allowed to operate by proscribing price-fixing activities in connection with the business of insurance.

St. Paul Fire and Marine Insurance Company
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Telephone (612) 221 7911

The St. Paul
Property & Liability
Insurance

March 6, 1987

The Honorable Orrin G. Hatch
Committee on the Judiciary
U.S. Senate
224 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Hatch:

At the February 18 Judiciary Committee hearing on the McCarran-Ferguson Act, testimony was offered by West Virginia Attorney General, Charles Brown, on the 1986 malpractice situation in West Virginia. Unfortunately, we believe Mr. Brown omitted a number of crucial facts from his testimony. As one of the companies cited by Mr. Brown, we felt you should be aware of what actually occurred in West Virginia last year. (Note that our 1985 market share of the West Virginia medical malpractice market was less than 12 percent.)

First, I'd like to explain why it was necessary for us to withdraw from the West Virginia malpractice market. Our action was necessitated by legislation which was enacted, without any opportunity to provide insurance industry input, that took away from us and granted to the State the right to decide when we could stop selling professional liability insurance in West Virginia — to one policyholder -- or to all policyholders -- no matter what happened there. Our decision was not a result of the legislature's mandate that we disclose our financial results, how we set prices, or our claims experience. We already do that.

Nor was our decision a result of the legislature's failure to enact tort reform. At no time has The St. Paul advocated or lobbied for tort reform. The St. Paul's position on tort reform has been, and is, that the facilitators of the system (insurers, lawyers, and the judiciary) should not be advocates of change or barriers to it. Only the users (injured parties) and those who pay the costs (insurance buyers and self-insureds) should decide what is a "fair" and "affordable" system.

The legislation which was adopted by the West Virginia legislature contained provisions which removed The St. Paul's right to make fundamental business decisions essential to any carrier's ability to successfully compete in today's marketplace. Specifically, the bill prevented insurers from exercising underwriting judgment to nonrenew a risk or class of risks.

The profitability (and potentially the solvency) of insurance companies is based upon their ability to exercise underwriting judgment to nonrenew policies which they judge will no longer be profitable. The legislation seriously limited our ability to exercise that judgment. This is particularly onerous if decisions on rate filings are delayed for any length of time. The limitations on nonrenewals, coupled with such a delay, would have forced us to remain on risks for which clearly inadequate premiums were collected.

The insurance provisions of the legislation were included shortly before the legislature was about to adjourn. Prior to the passage of these provisions we were given no opportunity to testify on their impact on our ability to write medical malpractice insurance in West Virginia. As soon as we learned of the insurance provisions included in the legislation, we told West Virginia legislators why these provisions would seriously restrict the ability to conduct malpractice business in West Virginia.

After the legislation was passed by the legislature, an executive vice-president of The St. Paul met with the Commissioner, the governor, and their staff members and informed them of the onerous nature of the legislation and the restrictive effect it would have on our ability to write malpractice insurance in West Virginia. Unfortunately, the legislation was signed into law on March 26, to take effect on June 6, 1986.

Before the legislation took effect, The St. Paul Companies was then forced, with great reluctance, to notify our professional liability insurance policyholders that their coverage was being cancelled. We decided to cancel our malpractice policies because the legislation prohibited us from being able to make necessary business decisions in the State of West Virginia. Our decision was based on an anticipated statutory climate which would totally impair our business judgment and operating policies, and adversely affect our ability to operate a viable business in the state.

Our policyholders were given thirty days notice of cancellation, in accordance with their policy provisions, which were generally to take effect on May 11, 1986 -- prior to the June 6 effective date. On April 14 our original cancellation date was extended to May 31 when we learned that reconsideration of the malpractice legislation was included in Governor Moore's call to the legislature for a special session to be held on or about May 13. When we extended the date of our cancellation notice, we indicated our desire to work with Governor Moore, Commissioner Wright, and the West Virginia Legislature to reach a reasonable solution to the problems posed by the law in West Virginia.

During the special session, the legislature amended the legislation to remove the limitations on nonrenewals and clarify certain reporting and rating requirements. The legislature did not, however, substantively alter any other parts of the bill and the final legislation included very stringent reporting requirements, limitations on cancellations, and mandatory rate hearings for any rate increase of excess of 10 percent.

Although the amended legislation imposes a number of restrictive insurance regulatory measures, it no longer, in our opinion, precludes our ability to make basic, crucial business decisions in West Virginia. As result, as soon as the amended legislation was signed into law by the governor, our cancellation notices were rescinded.

In addition to the legislative circumstances outlined above, an antitrust action was filed by the West Virginia attorney general. While we do not believe it is appropriate to comment extensively about the pending action, there are several additional facts we would like to bring to your attention.

In his testimony before the Judiciary Committee, Attorney General Brown placed great emphasis on the temporary injunction issued by the West Virginia Supreme Court of Appeals. However, he neglected to mention that the injunction was issued on May 9 -- after our cancellation notices had been extended until May 31. The amended legislation was ultimately signed into law and our cancellation notices rescinded before the effective cancellation date. Contrary to his testimony, Messr. Brown's actions had no impact on the continuation of malpractice coverage in West Virginia.

It is also interesting to note that Attorney General Brown failed to inform the Judiciary Committee that the temporary injunction was eventually dissolved by the West Virginia Circuit Court.

We might also point out that the West Virginia attorney general's office vigorously resisted efforts to have the lawsuit considered in Federal district court. This is a particularly peculiar in light of Messr. Brown's advocacy of repeal of the McCarran-Ferguson Act.

Finally, because boycott activities are not exempted from federal antitrust laws by the McCarran-Ferguson Act, it is incongruous that allegations of "boycott" constitute the basis for Messr. Brown's assertions that the McCarran-Ferguson Act should be repealed.

I trust this information clarifies for you what actually happened in West Virginia last year. I would be more than happy to discuss this matter further with you or your staff, either in person or by telephone. Please let me know if I can provide you with any additional information or if you have any questions.

Sincerely,

Sally Narey Frans

Sally Narey Frans
Government Affairs Officer - Federal Relations

SNF/bp

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MARK F. HORNING
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March 20, 1987

The Honorable Joseph R. Biden
Chairman
Committee on the Judiciary
United States Senate
Room 489
Senate Russell Office Building
Washington, D.C. 20510

Dear Senator Biden:

This responds to the questions in your February 19 letter concerning repeal of the McCarran-Ferguson Act, the subject on which I testified during hearings before the Judiciary Committee on February 18.

Your first and second series of questions focus on whether health and life insurers, as opposed to property and casualty insurers, would be affected adversely by repeal of the McCarran Act. The organization I represent, the American Insurance Association, is comprised of companies selling property and casualty insurance. Therefore, I do not feel qualified to address the impact that repeal of the McCarran Act would have on the health and life sector of the industry.

I can tell you, however, that there is no division of opinion between the different sectors of the insurance industry -- property and casualty, health or life -- on the question whether the McCarran Act should be repealed. Associations representing every sector of the industry unanimously testified in opposition to Senator Metzenbaum's bill, S.80, at the February 18 hearing. Associations representing independent insurance agents did likewise.

This unanimous opposition derives from the fact that the underlying policy of the McCarran Act has equal validity across all parts of the insurance industry. The McCarran Act recognizes that the federal antitrust laws and state insurance regulation often have conflicting objectives. This is true in the health and life lines of insurance, as it is for the property and casualty lines. The policy of the McCarran Act is to reconcile these conflicting forms of regulation by creating a limited antitrust exemption applicable only where operation of the federal statutes would interfere with state regulation. AIA believes that the McCarran Act's accommodation of federal and state policies is wise policy for all sectors of the insurance industry and is superior to an approach under which federal law would be given supremacy.

The federal antitrust laws, moreover, would not be the only federal statutes that would become supreme over state insurance regulation if the McCarran Act were repealed. The McCarran Act also precludes the Federal Trade Commission from exercising its non-antitrust, consumer protection powers to regulate insurance in conflict with state authorities. Repeal of the McCarran Act thus would permit the FTC to assume such a regulatory role, over all lines of insurance. Indeed, the Federal Trade Commission Act was amended in 1980 because the FTC, notwithstanding the McCarran Act's limits on its jurisdiction, unlawfully was seeking such a role in several major sectors of the insurance industry. State insurance commissioners had complained to Congress that the FTC's so-called "factfinding" reports and investigations, the most notorious of which were investigations into whole life insurance and automobile insurance, were thinly disguised attempts to create a federal role in insurance regulation.

I am able to provide you with more detailed responses to questions specifically pertaining to property and casualty insurance. Your letter inquired whether there is a difference between large and small companies, for McCarran Act purposes. It is certainly true that, the smaller the company, the more it benefits from the McCarran Act's antitrust exemption for intra-industry cooperation. Although the difference is one of degree, smaller companies tend to have more need of industry cooperation in pooling and analyzing rate-related data, since smaller companies have smaller internal data bases and less expertise. This is the major reason why AIA believes that repeal of the McCarran Act could actually decrease competition, not enhance it, and lead to greater concentration in the industry.

However, repealing the McCarran Act only as to large companies would not avoid this problem. To the contrary, such a step would have exactly the same negative impact on competition. Absent the existing McCarran Act antitrust exemption, large companies could not participate in industry rating organizations, could not furnish their information on losses -- a large portion of the total data -- and could not lend their financial support to hiring expert analysts available to all insurers. Small companies would, therefore, be as significantly handicapped in obtaining needed data and expertise as they would be if the McCarran Act were repealed as to all companies.

Even large insurers, moreover, benefit from the greater statistial reliability of an industrywide data base. In addition, large insurers invariably have lines of insurance where their volume of business is relatively small. In those cases, they have the same degree of need for aggregated data and outside expertise as smaller competitors do generally.

Assuming a supportable rationale for distinguishing between "large" and "small" companies, which I do not see, I also can see no practical way of implementing that distinction. Any "large" versus "small" distinction would be purely arbitrary. There is no point at which the volume of business is so substantial that a broader data base or greater expertise cannot contribute to more accurate ratemaking.

Moreover, any such distinction would have to be based on individual lines of insurance by state and type of coverage, not on the basis of an insurer's overall premiums. Since rates are made by state, by type, by coverage, an insurance company's volume of business in those categories determines the statistical adequacy of its internal data. Such distinctions, however, would result in massive regulatory confusion. The McCarran Act would apply to a company in some lines of insurance and some states but not in others, and that uneven pattern would shift annually as the volume of a company's business shifted by individual line or by state.

Your third series of questions asked whether modern data processing capabilities eliminated the need for an antitrust exemption applicable to cooperative ratemaking efforts. The short answer to this question is that modern technology has increased the *effectiveness* of industry data collection and analysis, but has not diminished the *need* for such cooperation.

Today, insurance industry data collection is substantially computerized. Undoubtedly, computers have made the compilation of data on a cooperative basis easier and less expensive. But this development has not reduced the need for an antitrust exemption. Individual company data, no matter how easily processed by computer, simply does not have the statistical significance of aggregate, industrywide data. Sophisticated data processing hardware and software is also expensive, making it even more difficult for small companies to compete absent a joint industry computer capability. Thus, accuracy in ratemaking still depends on insurers agreeing to channel their data into a large aggregate data bank. However, this form of cooperation, because its explicit purpose is for use in the determination of future prices, is precisely what the antitrust laws view with suspicion.

Nor could industry cooperation be limited to the mere reporting of raw data into a central computer bank, which could then be accessed by individual companies. Data on past losses is not understandable or useful unless there is industry agreement on how to categorize and report it. As a prime example, absent agreement on how to classify risks, data would not be reported in a format allowing meaningful prediction of future losses.

Moreover, the mere collection of information on losses is just the beginning of the ratemaking process. Even the most detailed and highly-computerized data can only tell you about the past. The data needs to be projected and trended into the future, if losses are to be predicted accurately. While computers can assist in this process, interpretation and analysis by experts is essential. Thus, an equally important benefit of industry cooperation is to develop the institutional expertise to turn raw data into usable information, a capability that has little to do with computers. The professional staff of industry rating organizations -- who are not employees of any insurance company -- combine the skill and objectivity necessary to do this job in the most efficient manner possible. It would not be economically feasible, especially for smaller companies, each to assemble their own staffs performing the same functions.

In sum, modern computer capabilities do not obviate the need for industry cooperation in the ratemaking area, but, if anything, have made it more important for smaller companies to have the benefit of such cooperation.

I hope this adequately responds to your questions. I appreciate the opportunity to once again present the views of the American Insurance Association on the McCarran Act.

Sincerely yours,

Mark F. H

Mark F. Horning

MFH/ngm

Texas Association
of Nurse Anesthetists;
Illinois Association
of Nurse Anesthetists;
Colorado Association
of Nurse Anesthetists

July 17, 1987

The Honorable Howard M. Metzenbaum
United States Senate
Room 140
Russell Office Building
Washington, D.C. 20510

Dear Senator Metzenbaum:

Over the past few months you have probably been hearing from the minions of the insurance industry that the move underway to repeal the McCarran-Ferguson antitrust exemption is a misguided effort which will not further the cause of insurance reform. Capitol Hill is overrun with these hired mouthpieces for one very simple reason: the insurance industry has taken the money to pay for their allegiance from the pockets of our members -- and your constituents.

On behalf of the two thousand five hundred members of our three state organizations, and on behalf of the American public, we urge that you listen to the voices of those who cannot afford to send lobbyists to Capitol Hill by the droves when you consider whether continuing this exemption for the insurance industry is a good or bad policy.

Our members are Certified Registered Nurse Anesthetists (CRNAs). As health professionals they provide anesthesia in a variety of settings in all fifty states. CRNAs provide a disproportionate share of anesthesia services to indigent patients. Liability insurance for the practice of the profession of nurse anesthesia has become extremely limited in availability and quite expensive. The high cost of such insurance has discouraged the entrance of many CRNAs into the health care delivery system on a part time basis; their salaries as part time providers would often be lower than their malpractice premiums! Often health care needs go unserved or underserved directly because of the high cost of liability insurance.

The Honorable Howard M. Metzenbaum
July 17, 1987
Page two

As with other allied health professionals, CRNAs have been plagued by unfair and discriminatory insurance practices by insurance carriers. These practices include denial of coverage to physicians who work with CRNAs or, more frequently, the imposition of unjustified surcharges on physicians who utilize anesthesia services provided by independently-practicing CRNAs. Many insurers who engage in these discriminatory practices are owned by state medical societies. These unfair and discriminatory policies and practices cannot be supported by either legal principles or actuarial data.

It is all well and good for the insurance industry representatives to parse the fine points of whether these or other insurance industry abuses are protected by the McCarran-Ferguson Act. No doubt the industry now claims the exemption is of hardly any defensive value. Parenthetically, one wonders why the industry would object so strenuously to the elimination of the exemption, which, to hear them tell it, seems almost the vestigial tail of an otherwise unobjectionable act. As potential plaintiffs we can assure you that the antitrust exemption does pose serious potential problems which discourage enforcement actions against the industry.

We urge you to support the repeal of the antitrust exemption for the insurance industry currently embodied in the McCarran-Ferguson Act.

Very truly yours,

Ron McBride /by WA
Ron McBride, CRNA
President
Texas Association of Nurse
Anesthetists

Betty Horton /by WA
Betty Horton, CRNA
President
Illinois Association of Nurse
Anesthetists

Linda Hislop /by WA
Linda Hislop, CRNA
President
Colorado Association of Nurse
Anesthetists

STATEMENT OF THE
AMERICAN ASSOCIATION OF
NURSE ANESTHETISTS

FOR THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

July 31, 1987

The American Association of Nurse Anesthetists ("AANA") appreciates the opportunity to submit this statement of its reasons for supporting the amendment of the McCarran-Ferguson Act and S.1299, The Insurance Competition Improvement Act. As described below, AANA has very specific concerns with certain insurance company practices. We believe these anticompetitive practices are protected by the McCarran-Ferguson Act exception to the antitrust laws as applied to the "business of insurance". We, therefore, urge this Committee to report favorably on S.1299.

The AANA is a national professional organization of approximately 23,000 certified registered nurse anesthetists ("CRNAs"). Anesthesia was established as a nursing specialty long before anesthesia evolved as a distinct medical specialty. Nurses have been consistently administering anesthesia since the 1890s and were the first health care providers trained as anesthetists.

The AANA was formed in 1931. In 1955, the AANA was recognized by the United States Office of Education as the accrediting agency for programs of nurse anesthesia.[1.] In

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[1.] The accrediting body is now the Council on Accreditation

(Footnote continued to page 2)

contrast, physicians prior to 1968, were classified as "anesthesiologists" merely by self-designation.

Anesthesiologists and nurse anesthetists have a unique relationship within the health care field. In anesthesia, the functions and responsibilities of nurse anesthetists and anesthesiologists overlap more than in any other specialty area. This is primarily true because the nursing specialty originated before the medical specialty and because of the nature of the practice. The vast majority of anesthetics are not administered to diagnose or treat a disease or pathology. Rather, the administration of anesthesia permits the primary medical procedure or service to be accomplished without pain. Patients do not go to the hospital to receive anesthesia. Judicial decisions and state laws and regulations have recognized that the administration of anesthesia is a proper nursing function as well as a proper medical function. The administration of anesthesia is not the exclusive province of nursing or medicine.

Further, CRNAs not only have a legal right to administer anesthesia, but are as qualified as anesthesiologists to do

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(Footnote continued from page 1)
of Nurse Anesthesia Educational Programs/Schools, an autonomous body located at the AANA's Park Ridge, Illinois office.

so.[2] In addition, virtually every state having laws and/or regulations concerning CRNA supervisory requirements does not require anesthesiologist supervision. Consequently, while prohibited from providing anesthesia services without physician supervision, direction, collaboration or consent, CRNAs are typically able to practice independently of anesthesiologist supervision.

CRNAs and anesthesiologists are unique competitors in the health care field because they are functionally interchangeable. In Bhan v. NME Hospitals, Inc., 772 F.2d 1467 (9th Cir. 1985), the Ninth Circuit Court of Appeals confirmed that nurse anesthetists compete directly with anesthesiologists.

In recent years, as medical schools have graduated more and more physicians, the number of physicians entering the field of

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[2] To be certified as a CRNA, a nurse anesthetist must be graduated from a nurse anesthesia program or school accredited by the Council on Accreditation of Nurse Anesthesia Educational Programs/Schools. In order to be admitted to a nurse anesthesia educational program, a person must be graduated from an accredited school of nursing, be a licensed registered nurse, and have a minimum of one year of critical care nursing experience. Nurse anesthesia programs are 24 to 36 months in length. Accredited programs and schools mandate that each student administer a minimum of 450 anesthetics to patients. This represents at least 800 hours of anesthesia time. Once a person graduates from an accredited program or school, he or she must successfully pass a written certification examination before being credentialed as

(Footnote continued to page 4)

anesthesiology has increased and competition with CRNAs has intensified. However, the median annual salary of CRNAs still remains far below the median annual salary of anesthesiologists.

As competition between these two groups increases, competitive methods are also changing. Recently, physician-controlled or owned insurance companies in several states have adopted or attempted to adopt surcharges, penalties or various other restrictions on physicians working with CRNAs. The surcharges and endorsements that have been adopted by physician-controlled insurance companies are not related to, nor are they designed to improve the quality of health care. The sole purpose of these surcharges and endorsements is to restrict the scope of practice of CRNAs.

Situations of which we have knowledge include insurance company surcharges to a hospital for surgeons who utilize the services of a nurse anesthetist without supervision by an anesthesiologist; refusal by an insurance company to provide coverage to CRNAs except when in accordance with the recommendations and guidelines of the American Society of

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(Footnote continued from page 3)
CRNA. The Council on Certification of Nurse Anesthetists administers the exam in association with a professional testing service.

Anesthesiologists; and offering insurance coverage to surgeons only if general anesthesia services are provided by an anesthesiologist.

CRNAs administer anesthesia with the same high rate of success as anesthesiologists. The only significant difference between anesthesiologists and CRNAs lies in the level of their respective education. This difference, however, does not affect the quality of care in anesthesia outcomes. Studies on mortality rates related to the use of anesthesia have indicated that there is no statistically significant difference in the quality of care delivered by anesthesiologists and CRNAs. *See*, for example, W. Forest, "Outcome - The Effect of the Provider," *Health Care Delivery in Anesthesia* (1980); A Bechtoldt, "Committee on Anesthesia, Anesthesia Related Deaths, 1969-1976," 42 *N.C. Med. J.* No. 4, (April 1981.)

Anesthesia seems to be an area where, beyond a certain level, outcome is only minimally affected by medical knowledge but is greatly affected by factors such as attention, concentration, organization, and the ability to function as part of a team; factors towards which all professions strive but on which no profession may claim a monopoly. In fact, this point is recognized in the recently announced standards of Harvard Medical School relating to anesthesia. The Harvard Medical School protocols are directed at *monitoring*, reflecting the fact that most anesthesia incidents relate to a lack of attention, not lack of education.

Anesthesiologists are influencing physician-controlled insurance companies. The influence of anesthesiologists can be seen behind the physician-controlled insurance companies' attempts to restrict the practice of nurse anesthesia. Anesthesiologists are usually either on the Board of Directors of these companies or have direct access to the members of the Board of Directors. While anesthesiologists have such direct access to the policy formulations of these companies, CRNAs are excluded from this procedure.

Thus, one health care provider is in the position to influence the practice of its competitor. While the United States Supreme Court has held that an organization can be held liable for the antitrust violations of its agents acting with apparent authority, American Society of Mechanical Engineers v. Hydrolevel Corporation, 102 S.Ct. 1935 (1982), the McCarran-Ferguson Act exemption effectively shields the practices we have encountered in the context of insurance companies.

The practice restrictions imposed by physician-controlled insurance companies have no legitimate purpose. There is no evidence that physicians working with CRNAs have a higher rate of claims made against insurance companies than physicians working with anesthesiologists. Furthermore, there is no evidence that physicians working with CRNAs incur greater expenses per claim than physicians working with anesthesiologists.

Insurance companies which are not physician-controlled arguably set their insurance rates based solely on experience, and they do not charge increased premiums for physicians working with CRNAs, nor do they adopt restrictions on their policies relating to physicians working with CRNAs. CRNAs are committed to administering anesthesia with the highest degree of care. The AANA does not object to other qualified health care professionals administering anesthesia. The AANA does object, however, to the antitrust activities used by other health care professionals and the insurance companies they control to restrict the practice of nurse anesthesia.

The penalties, premiums and restrictive endorsements are not designed to improve the quality of care. The effect is to restrict the practice of nurse anesthesia and to encourage the use of anesthesiologists. This anticompetitive conduct will unnecessarily increase health costs.

S. 1299 will remedy this problem by repealing the unnecessary protection from antitrust enforcement afforded to the insurance industry by the McCarran-Ferguson Act. The result will be to promote competition and prevent unnecessary increases in the cost of health care to the consumer.

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